



**Business Law Reform and
Alternative Dispute Resolution Development**

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**A REFORM BANKRUPTCY LAW FOR MADAGASCAR
COMMENTARY AND REVIEW**

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**A REFORM BANKRUPTCY LAW FOR MADAGASCAR:
COMMENTARY AND REVIEW**

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**REVIEW
OF THE DRAFT BANKRUPTCY LAW**

(Projet de Loi portant sur l'organisation des
procédures collectives d'apurement du passif)

February 23, 2000

I. INTRODUCTION AND SUMMARY

The Commission de Réforme du Droit des Affaires (CRDA) requested comments from ARD/Checchi with respect to the draft bankruptcy law (Projet de Loi Portant sur l'Organisation des Procédures Collectives d'Apurement du Passif), dated January 10, 2000. Under its contract with USAID, ARD/Checchi is pleased to provide review and commentary on the draft for the CRDA.

Our review is not exhaustive of the subject matter, nor under the terms of the assignment can it be. The focus is on the draft bankruptcy law of January 10, but bankruptcy law does not exist in isolation. Laws in the following areas also need to be considered: business forms (including but not limited to joint stock companies), accounting procedures and financial reporting, fraudulent conveyances, secured transactions, mortgages, laws related to judicial power and jurisdiction, and the corpus of the Civil Code. Nor does this review consider developing court procedures and legal authority in the form of regulations to implement a bankruptcy law. The CRDA will want to measure the validity of all aspects of a bankruptcy reform effort against the ability of Madagascar to enforce a reform bankruptcy law effectively and credibly, given existing financial resources and expertise in the private and public sectors, including the judiciary.

No conscious attempt is made in this review to advertise or even suggest the adoption of the bankruptcy code of another jurisdiction. At times, the comments will call into question the meaning of various legal terms or court procedures. Such comments are in the interests of the end users of the bankruptcy law, Malagasy businesses. As such, comments are not so much intended to question to viability of the present legal system as to probe its flexibility and responsiveness to this crucial domestic audience. It is hoped that the CRDA will weigh the comments herein for their current viability under existing business and legal conditions in Madagascar.

Finally, as this is a commentary, no attempt is made to suggest exact language in revision. It is assumed that acting on the observations below could lead to substantial revision of the draft text of January 10. ARD/Checchi will be happy, if requested by the CRDA and upon agreement with USAID, to participate in the next round of drafting and, of course, to elaborate on the observations below.

Comprehensive as the draft of January 10 is, the CRDA is now provided with an excellent opportunity to examine each assumption behind the current Malagasy bankruptcy regime and to measure it against the context of debtor-creditor and commercial relations generally. This is a most propitious time. Jurists, law enforcement officers and judges agree that the present law on bankruptcy is barely used and may have been “dead on arrival” when enacted in 1962 because the local business community has relied on informal ways to resolve debtor-creditor disputes.

This historical experience has advantages, for it enables Malagasy legislators, attorneys, judges and members of the private sector to incorporate those positive aspects of current informal business practice into a reform law that captures the current needs of Madagascar's economy. Reliance on informal business will soon not suffice, because the international financial community, the audience that provides what Madagascar needs most - capital and technology - is

and will remain for some time quite ignorant of local informal business practices. The solution is a reform bankruptcy law that incorporates the positive aspects of current Malagasy practice but that also speaks in the formal and public way that only laws can to this vital international audience. Accordingly, the draft of January 10, or any other reform bankruptcy draft, is evaluated according to the following four themes, each of which reflect these two factors:

- *The need for a bankruptcy law that expands the number of economic voices and minimizes the number of administrative ones.* To gain the confidence of the domestic and international business communities, it is essential to demonstrate that bankruptcy reflects the orderly reallocation of economic resources in a free market and is not merely the exercise of state administration.
- *The need to provide for resource reallocation that is efficient rather than punitive.* Bankruptcy proceedings involve large numbers of parties and thus efficiency is the aim; the present advantages of one-on-one dealing between creditor and debtor in Madagascar can best be preserved, while providing a deterrent to unconscionable debtor behavior, through development of a separate law on fraudulent conveyances that is enforced outside the bankruptcy process.
- *The need to facilitate economic calculations by setting forth concrete standards for each step in the bankruptcy process.* As the Malagasy experience to date has demonstrated, no commercial law, let alone one inviting participation in the complex process of bankruptcy, will be used unless economic actors such as firms and banks understand the economic consequences of each stage of the administrative process during bankruptcy proceedings.
- *The need to confine bankruptcy's social goal to efficient resource allocation.* Malagasy firms now resolve disputes as a result of their intimate knowledge of each other's operations; thus Malagasy households, firms and financiers will only demonstrate an interest in a reform law as a replacement to the present situation if the law demonstrates an interest in their economic interests and avoids holding any aspect of a law that holds the economic well-being of households, small and medium size businesses and those that finance them hostage to a larger Government social policy agenda.

II. THEMATIC ANALYSIS

One goal of the bankruptcy law is to assist the economic growth of all components of Madagascar's varied economy. The text of the January 10 draft is evaluated according to the points outlined above.

A. The Need For A Bankruptcy Law That Expands The Number Of Economic Voices And Minimizes The Number Of Administrative Ones

Bankruptcy and corporate reorganization are economic decisions sponsored under the aegis of the judiciary, which is not an economic policy making body. Hence, any given bankruptcy case should not be viewed as a license for a judge to make decisions of state economic policy. It is the private sector that can allocate and reallocate capital and resources most efficiently. Hence, a reform bankruptcy law must be fully democratic in the economic sense – that is, it must give

voice to all participants in the business of the debtor in question and be as precise as possible to the status and demands of each economic entity dealing with the debtor. Within the bounds of propriety and deference to the judicial and executive branches, a reform bankruptcy law should permit those economic constituencies most directly concerned with the debtor's performance to make use of bankruptcy to redirect capital or rearrange economic resources. This means giving those parties with the greatest economic motive to know the debtor's affairs a motive to use bankruptcy or reorganization to effect these results. These economic constituencies are:

1. The Debtor

Draft Article 25 imposes an obligation on the debtor to commence proceedings in the event the debtor cannot make payments. Yet the draft provides no guidance on objective standards based in modern commercial practice as to how the debtor makes such a calculation. The economic grounds for filing bankruptcy could include any one of a number of circumstances. These include negative net worth, declining cash flow, the inability to service debts and make obligations based on insufficient sales and orders, and a host of other reasons. The problem with developing an objective standard is that it will vary with the nature of the business. A cash-heavy business with fluctuating inventories differs from a large manufacturer with stable orders and earnings. The alternate approach is not to impose an obligation of the debtor to file proceedings but to give the debtor the economic incentive to do so.

A reform bankruptcy law should provide the debtor with an economic incentive to file by clearly stating that the outcome of successful proceedings is discharge of the debtor's obligations. This is more efficient than burdening courts with policing a standard that varies with the business. More important, it will give the private sector confidence that bankruptcy can serve the private business community by giving an unsuccessful business a new start and ensuring that creditors can be paid off in an orderly fashion in which they may well receive more than would otherwise have been the case. Draft Article 53 comes close to an explicit statement that the outcome of bankruptcy is discharge of indebtedness but this should be at the beginning of the draft law to emphasize the central economic importance of this idea.

2. Creditors

There are two general problems with the draft in this area. One is too little differentiation of the economic interests of creditors, except in final distributions in draft Articles 166-67. By contrast, the draft speaks little of input by creditors in the process of working through the debtor's obligations. Generally, in free markets, creditors who are less protected take a greater risk and therefore seek a greater reward. In bankruptcy, these creditors should receive less than others as they gambled on receiving a greater reward. Usually, unsecured creditors outnumber the secured creditors and the failure in the law to differentiate the legitimate security interests of some creditors from others will make lending difficult to small businesses in Madagascar. The reason is that if secured status means little in bankruptcy, banks and other lenders who tend to be conservative and not make unsecured loans will have no protection when a debtor defaults or has financial complications. Hence, there will be no economic motive to lend. Preference should be given to those creditors who: (a) hold security interests in that property that was purchased with loan proceeds of the creditor; (b) hold security interests in other property of the debtor; and (c) are otherwise preferred creditors by virtue of contract with the debtor. Such draft Articles as

those in draft Title II on the procedure “collective” that fail to distinguish among creditors require some reconsideration. This and related ideas are explored in Part III 2. b *infra*. A reform law needs to frankly recognize that the creditor is self-interested. The key to the neutrality mentioned in draft Article 41 is not a standard abstracted from the interests of the creditor; rather the key is to ensure that all creditors are represented in some manner so as to be heard in a manner proportionate to their interests. Recognizing the differences among creditors, neutrality is achieved by collective equilibrium. Again, this can only occur if the law expressly recognizes distinctions among creditors. Such draft Articles as draft Article 41, which disqualifies salaried employees from participation as a trustee (the French word “syndic” will be used for trustee), recognize the importance of avoiding conflict of interest but do not go nearly far enough in exploring the divergent economic interests of creditors in a modern commercial society. Hence, draft Articles 39-46 and such others as relate to creditor interests require reconsideration to more accurately differences among creditors before the liquidation in draft Articles 166-67.

The second problem the draft poses for creditors is a tendency to favor judicial policing power over letting concerned creditors develop a plan and permitting them to submit it without being overruled by unsecured creditors of the debtor. Such provisions as draft Articles 39-46 and 137-138 discuss plans for the formation of syndic of creditors and of cessation generally. Yet there is no direction as to standards for the review of either by the judiciary. Absent affirmative standards for the review of the proposal of a syndic, there is some question why creditors would serve, especially in complex cases when the interests of a particular group of creditors might appear diluted and the views of a creditor or group of creditors therefore qualified.

Just as a reform bankruptcy law needs to amplify on the number of economic constituencies in order to make decisions respecting capital and resource allocation as fair as possible, a reform law also needs to minimize the role of bureaucracy by the executive or judicial apparatus in the interest of a rapid reallocation of economic resources. The following are examples of the need to reduce administrative factors that impede the liquidation of assets and the reallocation of capital:

a. Estate Administration

Properly understood, there should be a manageable executive body directing the particulars of the preservation of the bankrupt estate and, as needed, of the disposition of assets. For example, draft Article 60 recognizes the need for such authority to avoid imminent loss of asset value. Similarly, the position of administrator or controller is not so much economic as administrative. Draft Articles 48-49 provide for some administrative functions, such as an inventory of the estate of the debtor. To simplify administration, there appears to be no reason why this administrative function could not be combined with the role of the syndic. In this case, the control function envisioned in draft Articles 48-49 would at least be combined with the standard of care and assurance of neutrality given in draft Article 41. Similarly, draft Article 137 in its various aspects presents the administrator as having a role in entertaining plans for the transfer of the enterprise or enterprise assets. Although there is the suggestion that the administrator will coordinate closely with the syndic, there is no reason why the syndic itself cannot perform such a function. Again, this minimizes bureaucracy; there is no compelling reason the syndic cannot perform the administrative role in accepting offers for the purchase of all or part of the bankrupt estate. It should be added that there is ample precedent in the current law of Madagascar for assigning the syndic an omnibus administrative role. Articles 482- 86, 508 and 526 and other articles in the

present law entitled “On Bankruptcy and Judicial Resolutions, on Rehabilitation and Bankruptcies and Other Bankruptcy Violations” (hereinafter referred to as the present law) view various ministerial functions as being handled by either an administrateur or the syndic.

b. Miscellaneous Parties

From time to time, the draft text mentions parties who may play a role in bankruptcy or reorganization proceedings without specification of precisely their role and their relationship to the court, the creditors and the debtor. Among such instances are: general assembly of creditors (“assemblée concordataire”) of draft Article 82, the conciliator (“conciliateur”) of draft Articles 7 and 35, and, more generally, the implication of the clerk of the court (“greffier”) in the bankruptcy proceedings. Under the present law, the involvement of the clerk or the office of the clerk (“greffe”) is invariably associated with immediate action pursuant to the instruction of a judge or as demanded by the text of the law itself. Articles 453, 459 and 487 in the present law are but examples of this. Such draft Articles as 35 and 36 continue this theme by calling on the office of the clerk to discharge responsibilities immediately. Yet, as evidenced by both the present law and the draft before the Commission, bankruptcy entails a series of intricate and detailed procedures peculiar to this area of practice. Given administrative resources presently available to the Tribunal de Commerce, it would be wise to consider whether the office of the clerk is equipped at this moment to assume the rigors and intricacies of bankruptcy process. Again, in the interests of ease of administration, it may be wiser to provide for the nomination of a syndic as soon as possible with the syndic handling all procedures directly. This would:

- conserve on resources of the already taxed court system;
- reinforce the confidence of the business community in the bankruptcy process by giving the debtor and creditors alike direct access to the syndic, an entity specifically assigned the responsibility of dealing with the one bankruptcy case that is the focus of their concern.

This is not to abolish the office of the clerk in bankruptcy proceedings. It is rather to accentuate the ministerial role of the clerk. The traditional role of the clerk as repository for all public records of court may be preserved by imposing on the syndic the obligation to inform the clerk of such developments as occur that are stipulated as necessary for the official court record.

The emphasis on centralization of economic interests need not mean a strengthening of the hand of the court. Quite the contrary, the syndic, as a reflection of the panorama of risk assumed by all parties, should not be subject to challenge by the court as to questions of judgement and discretion, except in instances of evident breach of duty. This role for the syndic will provide the proper motivations for the use of bankruptcy and creditor’s rights proceedings. There should be a concomitant effort to simplify the bankruptcy administration process.

B. The Need To Provide Incentive For Resource Reallocation That Is Efficient Rather Than Punitive

The plan of *redressement* set forth in draft Chapter V of Title II (draft Articles 119- 130) and the rehabilitation plan of Chapter II of Title III (draft Articles 204-14) on personal bankruptcy should have roughly the same economic goal: the orderly disposition of assets, not the punishment of profligate debtors. As a corollary, bankruptcy should carry no stigma; a discharge

in bankruptcy may give the debtor the necessary freedom to recapitalize a business and to start it on a more efficient path that can further the public goals of fuller employment and a wider array of choice for consumers.

A bankruptcy law, having as it does the goal of the orderly disposition of assets, does not have the luxury of taking on the task of exacting punitive measures either against the debtor or against the managers of the debtor. In even the most routine bankruptcy, there simply is neither time nor resources for these tasks. Thus, serious consideration should be given to the deletion of draft Articles 194-96 insofar as same extends bankruptcy proceedings to managers of bankrupt entities and to the deletion of draft Articles 203, 203.1, 226, 226.1, 228, 231, 233-34, 237 and 242 as compromising the true nature of bankruptcy. That nature concerns economic efficiency, not exacting punitive measures on wayward debtors. In fact, the term “fraud” has no place in bankruptcy proceedings. The necessity of ascertaining intent belongs to another part of the commercial law and to criminal proceedings. As to commercial law, as Madagascar does not have a law related to fraudulent conveyances, one should be adopted. It would have the following elements that may surely have a connection to a bankruptcy case but are nonetheless not a part of the formal bankruptcy proceeding:

- The questionable sequestration or transfer of debtor assets in general but especially prior to filing bankruptcy proceedings (with special attention paid to transfers to “controlling persons” as defined *infra*)
- The manipulation of the syndic, the notary (“*notaire*”), the controller (“*controlleur*”) or any officer of court in order to gain advantage in bankruptcy proceedings
- Collusion between creditors and the debtor with respect to the classification of obligations considered by the court in a bankruptcy case
- Abuse of multiple priorities as a creditor so that a creditor uses position in one class of creditors to prejudice the other classes

The above are just some examples. The point is that the judiciary should hold to account those engaged in that fraudulent transfers and indeed abuse of the bankruptcy process. But these are separate legal actions that should not interfere with a bankruptcy action. To economize, insofar as bankruptcy proceedings uncover such untoward behavior, the court in the bankruptcy proceedings should make it known to all parties prejudiced by such behavior so that same parties can use the judicial proceedings outside of bankruptcy to allege fraudulent transfers or abuse of the bankruptcy process.

In addition to conveying the message that bankruptcy is focused on economic efficiency and the public benefit of proper capital allocation, the elimination of punitive provisions in a bankruptcy law along with the enactment of provisions respecting fraudulent conveyances provide the following advantages to the Malagasy juridical system:

1. Superior protection against debtor abuse of the bankruptcy process

The Malagasy creditor community has little tendency at present to use the bankruptcy law. It is therefore less likely that this community will use the reform law immediately than that same will be used by debtors seeking relief from the legal consequences of indebtedness (though the text of a reform law should make discharge in bankruptcy a more evident goal of the law than is presently the case, both Article 607 of the present law and draft Articles 53 and 204, seem to set

forth discharge as a consequence by one means or another). This being the case, measures should be taken to prevent abuse of bankruptcy to further fraud. A separate law on fraudulent transfers will prevent abuse of the bankruptcy process by penalizing the debtor in undertaking the first step in the abuse process: the transfer of assets from the debtor to “controlling persons” (see explanation in Part IV *infra*) or under other questionable circumstances.

Draft Articles 228, 229, 231 and 237 all attempt to cover this area. But there are theoretical as well as practical problems that can be avoided by the adoption of similar prohibitions outside the bankruptcy law and in a law on fraudulent transfers. From the point of view of theory, there is no enunciation of the difference between a bankruptcy that is “simple” and one that is fraudulent, in the language of such draft Articles as 233 and 233.1. The difference of course hinges on intent but there seems to be no clear standard in civil law on this (arguably any voluntary filing in bankruptcy is susceptible to challenge as fraudulent insofar as it carries benefits for the debtor and seems to defeat the honest expectations and intentions of creditors at the commencement of their dealings with the debtor). The issue of intent is inevitable but should be reserved for criminal proceedings and for civil proceedings taken at the initiative of creditors who are concerned with a particular aspect of debtor conduct at a particular time, not with the bankruptcy process which, properly understood, deals with the panorama of debtor activity with all firms in all contexts. From the practical standpoint, the question of intent deserves special attention by those parties having the greatest economic incentive to explore it, the creditors themselves, which leads to the second advantage of a separate law on fraudulent transfers.

2. Permitting market forces to police business behavior

Such institutions as the syndic are a formal part of the bankruptcy process and have many duties and these are only indirectly the product of economic motivation of recovery from the debtor’s estate. In these two crucial respects they are unlike competitors or creditors of the debtor viewing the debtor’s dealings outside the context of bankruptcy proceedings. The development of a law on fraudulent conveyances will give competitors and creditors of the debtor who have the economic motivation to examine the debtor’s affairs the opportunity to pursue remedies outside bankruptcy process. This facilitates the exposure of improper behavior of the debtor free from the protocols and time constraints of the bankruptcy process.

3. Greater cognizance of different evidentiary formalities

Verification of the technicalities of creditor status in a bankruptcy action entails several formal steps, as evidenced by Section II of Chapter IV of the draft. By contrast, action by one creditor or a small group of creditors in connection with fraudulent transfer need not entail the same amount of complexity and focuses on one aspect of debtor conduct at one point in time rather than the debtor’s entire business history. Furthermore, fraudulent conveyance necessarily involves the issue of intent and its proof, although evidence of intent might be imputed by circumstances (e.g., the timing of the transfer relative to a filing in bankruptcy, the identity of the transferees, particularly if they are “controlling persons” as defined *infra* in Part IV, etc.). Bankruptcy proceedings, by contrast, ought not be concerned with intent. Along this line, it should be noted that although draft Article 242 distinguishes between simple and fraudulent bankruptcy, there is no standard for determining which is which. All this points to the need to take such questions outside formal bankruptcy proceedings and raise issues of fraudulent transfer in separate penal proceedings or in a commercial action subject to a detailed law of fraudulent transfer.

4. Superior Utilization of Talent of Madagascar Bench and Bar

In Western countries and most certainly in the United States, bankruptcy practice by both lawyers and judges is a true specialty. In fact, bankruptcy ranks with admiralty and intellectual property as a traditional specialty of the law in the United States. To suggest that the bankruptcy bar and bench are an elite is no exaggeration, and for good reason: of all areas of legal practice, bankruptcy demands greatest attention to the intersection of law and the complexities of firm economics – and it demands this attention not when the firm is in good health and normal but when it is *in extremis*. Years of training are required even when, and especially when, bankruptcy practice occurs in a modern commercial society.

A bankruptcy regime distracted by the concerns of the intentions of debtors and punitive measures will not help Madagascar develop an elite corps of attorneys and judges necessary to keep apace with the economic demands of analyzing debtor and creditor obligations. As noted in a fuller discussion of international standards below, bankruptcy is and will remain primarily a response to domestic economic conditions, no matter what the country. However, the increasing reach of international finance and foreign investment will expose the gap in expertise between Malagasy practitioners and judges on one hand and those of the nations whose capital and investment Madagascar presumably hopes to host on the other. This gap can only be closed by putting the focus of bankruptcy practice on sophisticated questions of firm economics and finance. A separate law on fraudulent transfers will free the bankruptcy process to concentrate on these commercial and economic issues while providing a judicial remedy for creditors seeking relief from nefarious debtor behavior.

C. The Need To Facilitate Economic Calculations By Setting Forth Concrete Standards For Each Step In The Bankruptcy Process

Too often, the draft of January 10 sets forth an expression that conveys legal significance without clearly and concisely stipulating when or precisely how this event should occur. One example of this is the announcement of commencement of proceedings (“la decision d’ouverture”) set forth in draft Article 72 and mentioned in various subsequent draft articles. It is clear from draft Articles 75 and 77 among others that the announcement carries great juridical significance. What is not clear is precisely when it occurs. Among the practical questions to be asked and that a new draft should resolve are:

- who is empowered to institute proceedings to secure the announcement
- whether the court may act alone to establish the announcement
- formal textual evidence of the announcement
- when the announcement begins (as of court decision, publication of court decision, etc.)
- whether once decided, the decision for the announcement may be revoked and by whom

This is not to say that the specialist cannot, without the benefit of interpretation, obtain from the draft of January 10 some of these answers. But too often the answer is not explicitly stated in the text or requires laborious effort to extract. The text of the legislation should educate creditors, debtors and other users of bankruptcy legislation. Similar situations exist with respect to confirmation of court (“homologation”) and the syndic’s request (“assignation du syndic”), the

former draft Articles 127, 129, 132 and 134-36 and the latter draft Article 183.¹ To the extent that there is explicit reference to bankruptcy procedures, same must provide definitive guidance as to how such steps are taken, when they conclude and their legal implications. This should be set forth in either the new bankruptcy law, to the extent they set forth the substantive rights of parties, or the Code of Civil Procedure, to the extent they bear on the means to exercise those rights. See elaboration on substance versus procedure in Part III *infra*. As it is, the draft text rarely refers to the existent Code of Civil Procedure (among the first references are not until draft Articles 154 and 155).

It should be noted that such international standards as are developing in the area of bankruptcy reform speak to such issues in emphasizing transparency as a controlling standard. This means not only that national bankruptcy laws provide clear guidance as to the mechanics of how creditors participate in the bankruptcy process, but that these national laws contain clear statements of the effects of each judicial action. See UNCITRAL Model on Cross Border Insolvency, Part I, Article 14; Part II, Article 3(c) (hereinafter cited as UNCITRAL Model).

D. The Need To Confine Bankruptcy's Social Goal To Efficient Resource Allocation

It would be unrealistic and undesirable to assume that bankruptcies and reorganizations exact no toll on the fabric of Malagasy family and community life. However, such consequences are best dealt with by social welfare laws and public assistance organizations that can devote their fullest energies to them, not by bankruptcy laws. The main object of bankruptcy legislation is microeconomic and not macroeconomic: to insure against the continued diversion of Malagasy and foreign capital and resources into a business that has not succeeded well in using them. A prompt decision for bankruptcy or reorganization will thus ensure that other domestic businesses needing capital and resources will receive them more quickly. This small but vital task, if executed quickly and efficiently, will bring fairness and equity enough to the Malagasy economy. To burden this task with the larger social concerns of employment and job stability will impede the fair reallocation of resources. Hence, the Commission is wise to reconsider those aspects of the draft which consciously introduce into the process of bankruptcy adjudication matters more effectively handled by specialists in social welfare. Among these questionable aspects are: in draft Articles 27, 110-11, 137.5 and 137.8 (with respect to “licenciement”).

It should be noted that the present law on bankruptcy is superior in this one limited respect; it does not distract the bankruptcy process with the broader, social implications of the debtor's behavior but rather leaves them to agencies and departments of government dedicated to this task. It should be noted that this is consistent with the trend of commercial legislation in mixed, transitional economies. Even in the republics of the former Soviet Union, for example, reform legislation in the commercial area is eliminating explicit references to such social concerns. Vestiges of it only remain in reform legislation on privatization, and this only because the commercial entities in question remain for the moment state enterprises predicated on the old state policy of full employment. Even in such a case, the authority of state officials to exercise discretion in the name of social welfare is being limited, may be qualified depending on the market forces driving the particular privatization and are usually phased out as stipulations to a transaction after a period of a few years or even months following privatization.

The above addresses the role of the state as maker of social policy only. It is not to suggest that the state in general and its social agencies in particular have no role as participants in the bankruptcy process. They do - when they have a direct financial stake in proceedings as creditors. As draft Article 149 recognizes, the state may have a role in collection from the bankrupt estate for social purposes and this draft article even establishes the order of state interests *vis a vis* other creditors. However, a review of draft Articles 165 and 166 suggests that the state position relative to other creditors may be easier to ascertain in the case of a claim to proceeds for the sale of personalty as opposed to realty. The Commission should reconsider the extent to which the draft of January 10 takes into account the full range of state interests as a creditor. In this regard, the bankruptcy law is but one aspect of the larger policy of tax collection and overall revenue enhancement.

III. IMPORTANCE OF SIMPLIFICATION

The typical businessperson of any country knows only so much of the law as he or she needs to use. And he or she uses only so much as is known. Herein lies the dilemma of Madagascar's present law on bankruptcy. It is multiple times the length of the national Constitution and several times the length of other legal authorities in Droit Commercial, such latter authorities purporting to govern matters of business that are more normal - and profitable. As noted, the domestic audience has ignored this law a variety of reasons. But what of the critical audience of financiers worldwide? The sheer size of the present law suggests to this audience that Madagascar has considerable, and perhaps unfortunate, experience with bankruptcy. Its present length and complexity are hardly an advertisement, either for its use by a domestic audience of limited resources or a foreign audience looking for a prime economic opportunity.

In short, as a public statement of policy, the present law on bankruptcy has offered the worst of both possible worlds. It has succeeded in alienating that audience who should most use and understand it, the domestic business community, to the point where after two generations of business, it is largely unknown. At the same time, its sheer size conveys to the vital international financial community with least knowledge of Madagascar that the country has considerable experience with business failure and insolvency, when in fact the opposite is the case.

The standard for a bankruptcy law in any country is whether the businessperson or banker of modest sophistication can review some of the text without the assistance of a lawyer and secure some basic idea of rights and responsibilities. This is vital in *the* area of commercial law in which, almost by definition, many parties in difficult financial circumstances who might use the law simply cannot afford a lawyer to educate them on the basics of bankruptcy. Fraught as it is with administrative practices and procedures, the draft text of January 10 offers little improvement over the present bankruptcy law. In fact, it is longer. It also seems to introduce more specific protocols with respect to the handling of particular creditors, as draft Articles such as 95-100 suggest. It also may involve more agencies of government, as indicated by draft Articles such as 47, 95 and 137.8. In short, the draft of January 10 provides little reason to believe that the text of the bankruptcy law will be any more accessible to those who need to know and understand it than is presently the case. Needed simplification might proceed from recognition of two points identified below:

A. Focus on Substantive Rights, Not Procedures

Notwithstanding the above problems, the present draft effort points to a solution to the problem. Not only the structure, but the title of the draft of January 10 suggests a solution. Draft Articles 162.1-12, 200-02 and 208-14 indicate that there are clearly procedural implications to bankruptcy. And the titles of the January 10 draft and the present law speak of either rules or procedures. Thus, the present organization of the law suggests that a text that is abbreviated and simplified, and hence coherent and useable, might be drafted. The reform law would be limited to a precise description of substantive rights of each party in bankruptcy and only contain a bare minimum of procedure.

In most jurisdictions, there is a distinction between matters of substance and procedure. Roughly speaking, the former is concerned with the description or grant of special largely recognized claims or capacities, whereas the latter concerns the specific means of enforcing same. In this context, the division between substance and procedure might be developed as illustrated by two hypothetical cases, using generic bankruptcy principles:

Hypothetical 1 – Substance: creditor’s right to notice; Procedure: steps to filing notice;
Intermediate: steps after filing of notice that order creditor’s claim

Hypothetical 2 – Substance: creditor right to notice from debtor; Procedure: how debtor provides notice; Intermediate: nature of creditor response to creditor committees following debtor notice

Using this tripartite division of substance, procedure and intermediate questions, one might classify the January 10 draft law roughly as follows:

Substantive articles – 1, 2 bis, 3-4, 5-7, 9, 25-28, 67-71, 72-77, 91-118, 194-99, 203-07, 226-51

Procedural articles – 2, 8, 29-38, 39-51, 200-02, 208-14

Intermediate articles – 52-66 bis, 78-90, 97 bis, 119-93, 215-25

The ultimate objective is a bankruptcy law emphasizing substantive rights and discussing only as much procedure as the business community needs to know in order to assert its rights. The most important procedural questions are: the manner and content of filing a petition in bankruptcy and a proof of claim; the composition of the syndic; and any appeal process. Thus, the draft Articles concerning procedure, and many of the intermediate draft Articles identified above, could be set forth outside a bankruptcy law and thereby simplify the law. The many draft Articles classified as intermediate, particularly draft Articles 119-93, should be scrutinized to eliminate such procedural references as they do contain. These would include reference to notices, notice periods, the authority of purely administrative officers of court such as the greffier and the time period during which the judiciary must act. The removal of such subjects from a draft reform law would contract draft Articles 119-93 alone by some 30-40%. This, combined with the elimination of many of the punitive provisions at the end of the January 10 draft as outlined in Part II *supra*, would put the draftspersons on the way to developing a much shorter bankruptcy law speaking more directly to the domestic and international business communities.

This would make the law useable by laymen through eliminating reference to the procedural provisions, which are the special province of lawyers. There are at least three possibilities as to where these procedural articles could be found outside a reform bankruptcy law:

- Code of Civil Procedure – The draft references the Code of Civil Procedure; a separate section devoted to bankruptcy procedure would facilitate use of both the reform bankruptcy law and separate procedural questions by eliminating lengthy and cumbersome text
- Rules of court – The Tribunal de Commerce might propose the draft procedural Articles, or something like them, as special rules for the conduct of bankruptcy cases; this would have the advantage of actively involving the judiciary, a crucial component of success in any bankruptcy regime, directly in the reform process and thus secure valuable input into the resources and tolerances of the court system for bankruptcy cases
- A separate law - This would have the advantage of underlining the uniqueness of bankruptcy procedure and be consistent with the tradition of the present bankruptcy law, which is to treat procedural considerations in bankruptcy outside the Code of Civil Procedure

It might be noted that the distinction between substantive and procedural aspects of bankruptcy is becoming increasingly recognized by the international business community. In fact, the UNCITRAL Model is largely predicated on the need to preserve substantive rights in bankruptcy across borders in cases where the different court procedures of many jurisdictions may be simultaneously involved. Concentration on substantive rights in a reform bankruptcy law while leaving procedural aspects for other legal authority is thus consistent with the direction of international authority.

B. Areas of Comment As To Key Procedures

This commentary will not explore in detail those aspects of bankruptcy procedure which are largely rooted in the French pedigree of Malagasy law. However, as noted, there are some procedural aspects of the bankruptcy that are of such importance that a reform bankruptcy law must include them. To succeed, the description of procedures in a reform bankruptcy law must read like an instruction manual that the business person of reasonable sophistication can understand. The key questions are what, how and when. As noted, this is a key aspect of the evolving standard of transparency set forth in the UNCITRAL Model. Among such areas are:

1. Proof of claim – Draft Articles 78-118 deal in one aspect or another with this but are far too complicated. A simplified claims procedure should focus on: the essential evidentiary components of proof of claim for unsecured and secured creditors, identifying documentation that must be filed with the proof of claim as precisely as possible, and a time frame within which a decision on the list of creditors must be made. Draft Article 26 attempts some of this but alternately refers to the filing of mere information on one hand and more formal documents on the other. Draft Articles 79, 87 and 88 address these questions but only in a provisional way. No where is there a statement of where a creditor or other party might find a final and binding list of creditors. Similarly, there appears to be no provision for late creditors to register under stipulated conditions in which the delay is justified.
2. Appointment of syndic – As argued *supra* in Part II, the syndic should handle all administrative questions relative to the debtor and the debtor's estate incident to the need to minimize the role of the judge and of purely administrative officers in the bankruptcy process and maximize the number of representatives qualified to advance economic claims. As draft Article 43 attests in identifying the syndic with creditor interests, the syndic assumes such an

economic role. Apparently Malagasy law imposes official duties on the syndic under which the syndic assumes responsibility as an *auxiliaire de justice*. If so, there is no need to burden the greffier with tasks such as verification of salaries as set forth in draft Article 79.1 and public announcements as set forth in draft Articles 87-88 and 90. The syndic is chosen for its special competence in this area and is more than adequately equipped to centrally administer such matters.

The problem is that for a post of such importance, the draft of January 10 says remarkably little about the procedure surrounding the choice of the syndic. Draft Articles 42-43 present the possibility of multiple and simultaneous syndics, without stipulating the ground for this. One reason might be the determination of court that a given firm's estate entails a great deal of administrative work and that a division of labor is necessary. But another reason may be that insofar as a syndic represents creditors, as foreseen by Article 43, there may be differences among their interests. As noted in Part I *supra*, the differences between secured and unsecured creditors are particularly pronounced. A draft law may wish to stipulate that multiple syndics may be appointed not only to account for division of labor, but to represent different creditor interests. The creditors need a voice and should be empowered to petition the court for same. Also, they should be allowed to request the appointment of a syndic having duties that have a special bearing on their interests as creditors. Of course, the court would be allowed some discretion in determining the number of syndics and whether, in case of the need to represent diverse creditor interests through multiple syndics, the court might apportion responsibilities accordingly (e.g., the court exercises discretion to give secured creditors having an interest in the land of the debtor representation through a syndic whose duties are the administration of same and the analysis of claims in connection with the land).

It should be added that capital intensive countries outside the francophone world, such as the United States and Germany, have bankruptcy regimes that reflect diverse creditor interests for different reasons. In the United States, it tends to be a matter of jurisprudence; different creditors have different representation in the bankruptcy process out of a feeling that under the law of contract, they have different interests and should be heard through representation. In Germany, capital markets drive the explanation. Banks are typical creditors and frequently own a large number of shares in debtors. Precisely because such "insiders" frequently determine the course of debtor conduct in and outside bankruptcy, German law takes care to insure that the interests of the spectrum of creditors is reflected in some manner. In short, this is one of the few areas of the draft Articles in which more, not less, needs to be said about procedures. International practices support this view. The related issue of possible conflict of interest as to the syndic will be discussed in Part IV *infra*.

Bankruptcy proceedings are alone complicated enough in accounting and business terms without the need for undue complication from a legal standpoint. Detail is important but a reform law in this area needs to make bankruptcy administration as simple and streamlined as possible. This is essential for the benefit of debtors and creditors in households and small and medium sized businesses who are apt to have less direct experience with legal matters. The need is particularly compelling in the case of assertion of matters of legal right. This is why the reform bankruptcy law needs to showcase matters of substantive right, to detail only the most essential procedures and to leave other procedural matters for other legal authority.

IV. FOCUS ON INTERNATIONAL STANDARDS

From time to time, the discussion above has referred to international practices. To the extent it has done so, it has done so sparingly – and this is deliberate. This is because too often developing countries have adopted legal models pell mell on the grounds that they represent conformity with international standards. The result is a most unfortunate situation in which government executives and legislators – to say nothing of the private sector – have no idea of how the given law adopted integrates into their legal system. Consequently, as a juridical matter, they have little idea of what the law they enacted means. The result is pure chaos – especially in the area of commercial law where laws necessarily interrelate and ideally should convey a consistent message. Having the best of intentions, a country may enact a “German” law on business entities, an “English” law on insurance and an “American” law on negotiable paper all of which may all touch a single business transaction. Yet, unless more effort is taken to integrate the international standard to local business practice and the domestic legal system, the result is a hodgepodge.

The good news for Madagascar is that the above worst case scenario is far more common in the former Soviet Union which has had to reinvent a market friendly legal system virtually overnight. Here, an established domestic judicial order does exist against which to measure proposed reforms. Nonetheless, care must be taken, especially as regards the application of international standards to areas of the law that deal with business transactions.

This is because in the area of laws governing business transactions, it is the business practice that defines the international standard rather than the other way around. To make this clearer, it is helpful to develop a contrast with laws that deal with compliance, rather than transactions. The former laws demand a government enforcement body whose existence depends upon conformity to international standards set by corresponding government bodies around the world. Classic examples are intellectual property and customs. The very success of the enforcing body in these areas depends on rigorous enforcement of carefully accepted and formally adopted international standards. By contrast, laws dealing with transactions need to recognize that the motive of the actor is not compliance but profit. The rules defining a transaction are thus focused on the contract between two consenting parties. What does this understanding of international standards mean for bankruptcy, which must consider the application of standards on a firm, transactional level, yet which at the same time involves multiple parties and contracts? Of all areas of legal reform having direct impact on economic policy, bankruptcy is among the most sensitive. This is because, by definition, bankruptcy involves a simultaneous number of claims upon a firm that is unable - or very nearly unable - to satisfy them.

Precisely this complexity has lead to the international business practice that leaves bankruptcy a largely domestic matter. ***The international standard, such as it exists, is a demand for a clear and transparent law in every country that minimizes administrative details and makes most economic sense***, a law very much along the lines of the four themes set forth in Parts I and II of this commentary. It is true that certain authority cited above, such as the UNCITRAL Model, aims for the attainment of international standards of a sort. But the aim of the UNCITRAL effort is not so much to make international practices as to capture them. The UNCITRAL Model’s signatories are states trying to keep abreast of the practices of international businesses, not trying

to define them. In fact, the UNCITRAL Model is a concession to the international practice of largely deferring to domestic judiciaries in the execution of bankruptcy policy.

And the demands of international firms as to bankruptcy are great, if only informal. Cross border capital flow and increasing competition among developing countries for capital and technology from Japan, Europe and the United States make it imperative that developing countries signal to foreign investors know that a reliable and relatively simple bankruptcy procedure is available to account for the “worst case” scenario that all multinational companies and financiers must take into account. Nor is international arbitration, the most frequent panacea for foreign investors, adequate to address a case of the insolvent company, which is likely to face demands from all sides. An equitable resolution of such cases can only be had within Madagascar, where all investors and claimants, domestic and foreign, from all sectors of the Malagasy economy stand on equal footing.

To say as much is to state that conformity with international standards is a benefit not only to the largest foreign investors but to the smallest domestic ones as well. Small and medium sized businesses with a lack of sophistication in a legal system rooted in the administrative and bureaucratic habits of the colonial period will be among the largest beneficiaries of transparency in and simplification of a reform bankruptcy law.

Thus, the international standard is economic efficiency, not cultural affinity. In its name, the Commission is encouraged to discard any aspects of a model, or the present bankruptcy law for that matter, which present unnecessary delay in the bankruptcy process, impede the debtor firm’s reorganization into a more productive industrial or commercial format, or without the most compelling evidence of direct and immediate harm to the health and safety of the public, interfere with the play of market forces in the bankruptcy process. Such elaborations on the international standard of economic efficiency have been discussed above in Part II. In addition to the points made above, special scrutiny must be given to:

A. Differentiations in the Draft Law that Make No Sense in the Context of a Modern Economy

Among these are found in draft Article 137.1 which prevents persons or entities related to the debtor from presenting a “plan de cession”. A similar idea exists to prohibit business dealings by a syndic under draft Article 51. The efficient employment of human resources dictates that persons and entities most proximate to the debtor be given an opportunity to demonstrate their exceptional awareness of firm operations by presenting a plan or even purchasing property in the debtor’s estate. This is not to say that such plans should not be scrutinized for the possibility of self-dealing or unjust enrichment. However, the Commission is encouraged to permit such persons and entities to participate in the bankruptcy process subject to special scrutiny of plans or proposed purchases by the court. There is no international formula for such scrutiny. However, the sophistication of international mergers and reorganizations has prompted lawmakers in many countries and such international organizations as Transparency International to identify with greater precision than draft Article 137.1 the circle of persons or entities who have special ties to a firm. Special scrutiny by the court would occur in cases involving “controlling persons” of the debtor. Controlling persons could be defined as those who are related by blood, marriage or adoption or have been:

- an employee, officer, director or manager of the debtor
- a creditor of the debtor, including but not limited to a judgement creditor
- a person having a direct or indirect equity or partnership interest in the debtor that equals or exceeds 5%
- a party having an option through management contract or other device to purchase an interest in the debtors estate that equals or exceeds 5%
- the representative, agent or employee of any person or entity who is a controlling person of the debtor's estate

These and similar ideas might bring a court closer to defining possible conflicts of interest in a modern corporate setting but yet permit some transactions that make economic sense. The interests of the family member, corporate officer, or syndic would be scrutinized on a case-by-case basis. The underlying assumption here is that the informality of the Malagasy economy permits the development of a great economic resource, the “know how” of individuals and firms having intimate contact with the debtor firm. The Malagasy economy can capitalize greatly on this investment by permitting the transfer of such “know how” from households, small businesses and financiers that know a troubled business and can therefore more efficiently transform it, or parts of it, into an ongoing enterprise, subject to careful court scrutiny of plans and purchases proposed by such controlling persons.

B. Regional Versus International Standards

The regional trading bloc is rapidly replacing the nation-state as that unit offering most sustained resistance to global economic trends. It is not now unusual even for economically powerful nations like the United States to look to their immediate neighbors as a source of security in these turbulent times of expansion and contraction in the new international economy. It is thus natural that the OHADA draft law comes to the Commission's attention and has provided some basis for the January 10 draft law. But the ultimate international standard is one that is pushing all countries to reexamine their commercial laws: economic efficiency. This is not by any means to say that the legacy left by the French system of civil law is diametrically opposed to this standard. There is very much to be said for retaining legal traditions when they are easily recognizable by all levels of the Malagasy commercial community and do not impede the neutral and prompt reallocation of resources that is the aim of bankruptcy and reorganization policy. It is, however, to say that if, as in the case of bankruptcy, economic growth and efficiency are the main occasion for a review of the legal regime, Madagascar no longer has the luxury of relying on “tradition” alone as a basis for justifying its bankruptcy regime. This is especially the case when, as in Madagascar, the local business community has never incorporated the current law into its traditions. As to those aspects of the draft that take fullest advantage of the proven and reliable aspects of the francophone model at no economic cost, the Commission is indeed encouraged give most serious consideration to their incorporation. But compliance with international standards should assume precedence and this means top priority should be given to the development of a new bankruptcy law that is simple and clear for both international and domestic business communities and features the minimization of administrative factors and the accentuation of economic ones. The latter criteria are of especially vital importance at a time when the present judicial system is relying on limited public resources.

The commercial law not understood or used by businesses is not fully, or even primarily, commercial. Ideally, some of the ideas expressed in this commentary will be considered in the interests of the most genuine reform Madagascar can make in its current bankruptcy regime: to make it understandable by and useable for all components of Madagascar's present and hoped for economy.

BANKRUPTCY REFORM IN MADAGASCAR

28 March 2000

I. INTRODUCTION AND SUMMARY

Bankruptcy is unique among commercial laws. This is because it supports a transparent and judicial determination that is at once comprehensive, prospective in application and retroactive in effect. As it simultaneously deals with firms *in extremis* and involves a comprehensive determination as to all aspects of the economic life of a firm, its success or failure is a microcosm of the degree to which the business community of a given legal system has confidence in the rule of law.

For all these characteristics, bankruptcy marks a crossroads in the development of Malagasy commercial laws. This is because its comprehensive, prospective and retroactive character makes it:

- a litmus test of the reliability of the legal system for bankers and investors, particularly those with the critical long term capital and technology necessary to open resource based commercial sectors and no alternative but to rely on local co-venturers and borrowers
- the most obvious politically neutral source for capital allocation, rooted as it is in court system and implemented at firm rather than macroeconomic level
- the reference point that the international financial community has in terms of gauging the risk of a “worst case” recovery scenario

All three reasons above demand a law and a bankruptcy regime focused on economic factors. The present Malagasy law falls short for its failure to emphasize the economic interests of debtors and creditors alike in a simple and transparent process; it rather focuses largely on penal and social concerns. The situation is drastic in terms of practical jurisprudence; the current law is an irrelevant vestige of the colonial period. Legal reform thus demands a law that is not different in degree but in kind.

II. CURRENT RELEVANCE OF BANKRUPTCY TO MADAGASCAR

The vast majority of judicial proceedings are adversarial. This means that they are a “zero sum” game in which each party is on one side or the other of a winner-take-all proposition. For this reason, a buyer confronts a seller, a lender a borrower, a consumer a producer.

Bankruptcy is entirely different. It is the only judicial event in a commercial context in which a court acts both retroactively and prospectively on behalf of all parties concerned. Bankruptcy determinations thus carry unique breath, both in terms of the number of the economic actors they affect and in terms of their ability to impact upon firm decisions at each point in a firm’s history and future dealings. For all these reasons, though fashioned by the politically neutral judiciary, bankruptcy has a considerable impact as economic policy.

The above is a general characterization of the importance of bankruptcy in general. But of all commercial laws, why is bankruptcy so important for Madagascar? And why now? Here are five reasons:

- *efficient capital allocation* – With the threat of double digit annual inflation, it is particularly important that such capital as is available in the economy be efficiently used. This means the prompt and definitive disposition of the total obligations of a firm heavily in debt that can only take place through formal bankruptcy. The present business practice in Madagascar of resolving indebtedness issues informally, one creditor at a time, often perpetuates inefficiencies that can otherwise be resolved *in toto* by the bankruptcy process. Transparent bankruptcy proceedings in a court of law entail looking at the entire operations and obligations of the firm in a formal, transparent manner.
- *encouraging financing of lucrative local industries* - Mining and local infrastructure projects like road building may well be an important part of the investment profile for Madagascar in the coming years. But they are capital intensive industries and are likely to entail lenders taking security interests in project equipment and other capital goods as a precondition to the extension of loans. The viability of bankruptcy in the “worst case” scenario lessens the risk of secured lenders and makes them more willing to make secured loans.
- *encouraging foreign investment in lucrative local industries* - The need for local licenses in industries such as mining and construction, coupled with the need for foreign capital and technology, is likely to make the joint venture between a domestic and a foreign firm a preferred business format in Madagascar for the foreseeable future. In this context, foreign financiers and would be investors will pay careful attention to the presence of a stable bankruptcy regime as a protection in dealing with local companies. Thus, a stable and transparent bankruptcy regime has a significant salutary effect on foreign companies who are exploring business opportunities in Madagascar.
- *orientation to local capital markets* – With venture capital virtually non-existent, banks dominate Malagasy finance. As inherently conservative financiers obtaining a relatively low rate of return, banks normally focus on such “downside” questions as security interests and analyze all transactions from the standpoint not of return, but from the standpoint of risk. Bank dominated capital markets therefore put a premium on a stable and predictable bankruptcy regime. The two most recent eras of Malagasy banking were nationalization followed by a brief period of domestication. In both the era of state management and the subsequent period of cosy domestic “relationship” banking, bankruptcy had not come to the fore. Under either socialism or crony capitalism, problems were worked out among friends. Times are changing. Foreign control of or participation in what had been domestic banks means credit controls from foreign headquarters in Paris or elsewhere and stringent foreign audits – both by in house staffs and by government supervisors. Under such strict controls, even but a few problem loans in Madagascar will occasion questions. A credible bankruptcy

regime in Madagascar can help assuage the concerns of bank examiners and promote lending by banks, the only real players in Madagascar's capital markets.

- *land* – This is the source of much of Madagascar's wealth and will remain so for some time to come. As in many developing countries, the trick is to effect a marriage of natural wealth with modern technology. But this can only be done with foreign capital and expertise. Profound cultural and social considerations preclude foreign land ownership in Madagascar. Adherence to this policy does not preclude foreign investment – but it means that Madagascar must enact legal reforms in other areas outside the question of landholding in order to compensate. Surely, bankruptcy is one of these areas. This is because it treats the disposition of risks taken by foreign lenders and investors. Without a bankruptcy regime that subjects a debtor's real property to management by a trustee bound to respect the claims of foreign and domestic parties alike, foreigners are at a distinct disadvantage. They have been and will remain most reluctant to bring the needed capital and technology to Madagascar if they never have a voice in the allocation of land. On the other hand, a stable bankruptcy regime will at least give foreign creditors some voice in the disposition of assets, including real property, through shared participation in such organizations as the trustee in bankruptcy (or "syndic").

Note that the latter four of the five factors above all share one thing in common: they all look at bankruptcy from the standpoint of the would-be creditor, from the standpoint of the investor or the bank. Both value the prospective, retrospective and conclusive aspects of bankruptcy from different vantagepoints. The banker looks at risk measured against the cost of funds, either from domestic savings or from international sources. As Madagascar has precious little of the former, referencing the latter is of particular importance. The operation of a transparent bankruptcy system is particularly important for a banker in this environment. Bank lending in all countries is based on weighing risk against a rather thin, narrow return. Risk is the independent variable in the determination to lend. Without a reasonably credible and transparent bankruptcy regime in a country like Madagascar which is so dependent on external funds, the banker has little formal and authoritative guide to performance by the local business community. This severely impacts the banker's ability to calibrate risk and weigh it against the modest reward banks, by nature, take in lending. It is thus little wonder that an absence of long term bank lending and a stable bankruptcy system have gone hand in hand. World Bank Country Study: Madagascar, International Bank for Reconstruction and Development, p.p.154-55 (referred to as IBRD Study). The prospective and retrospective aspects of bankruptcy determinations enable a banker to calibrate that something might be obtained in a "worst case" scenario and this facilitates lending.

The investor has a different perspective from the banker and is far more oriented to taking greater risks for greater rewards. Nonetheless, bankruptcy is important to the investor for its comprehensive quality. This is particularly true in a country like Madagascar, where the principal resource a Malagasy partner brings to a business enterprise is a knowledge of the local business culture. Foreign investors, particularly those maintaining a low local profile, often rely on local partners and co-venturers to

assume significant day-to-day management responsibilities. They thus need a formal process to ensure that, in case of complications with their businesses, they have a reasonably sure handle on the number of legitimate claims that can be made on the business at any time. Formal bankruptcy proceedings may not be necessary, but the potential of bankruptcy proceedings, or merely proceedings for the design of a rehabilitation plan, give the removed foreign investor some degree of control over the enterprise. For its comprehensiveness and formal nature, it enables the investor to gauge the problems and potential of the investment.

These two perspectives relate to bankruptcy's importance as a tool at micro, firm level. But bankruptcy also has significant importance for the first of the five reasons mentioned, which is Malagasy macroeconomics. Current restrictions on land ownership severely limit the opportunity for foreign direct investment. As noted, domestic savings have been quite low relative to many countries, even those in transition. IBRD Study, p.p. 74-75. This means that to stay faithful to monetary discipline, Madagascar will have to reallocate that capital currently at work in the economy to other sources. The traditional Malagasy manner of one-on-one dealing to resolve issues of indebtedness is not equal to this task. As noted, a reform bankruptcy regime dispatches with existing and anticipated legal disputes and does so comprehensively.

These characteristics of retrospective and prospective operation as well as comprehensiveness in breadth are understandable. But how are they translated into law? A review of current trends and practices is in order.

III. INTERNATIONAL STANDARDS

The standards of retrospective and prospective operation as well as comprehensiveness have their basis in trends in modern bankruptcy practice, trends manifest at present no matter what the cultural or ideological background of the country.

1. Retrospective and Prospective Operation

This standard is quite compatible with a civil code system, such as that found in Madagascar. This is because the civil code system sets forth in a most transparent and public way the path to reform. It establishes in a general Civil Code the primary principles of debtor-creditor relations that provide the basis for bankruptcy determinations to adjust past obligations and provide a sound footing for capital reallocation. Among features common to all civil codes are: the nature of indebtedness, proper demand for payment and rights of the creditor versus other parties having claims on the debtor and other features.

But the 1990s have seen the largest wave of legal reform in civil code systems, one that dwarfs the commercial legal reforms of civil code countries in the late 19th and early 20th centuries. And that reform has taken place in a most unlikely place – the former Soviet Union. *What is most important for Madagascar to realize is that this wave has adjusted the expectations of an increasingly homogenized international financial*

community as to what a bankruptcy law in a developing country should be. The unique retrospective and prospective operation of bankruptcy is the ideal formulation for capital reallocation. The international expectation is thus economic efficiency, not cultural affinity. Ironically, the absence of capitalist and market tradition in former Soviet countries made them ideal laboratories for focusing on the economic consequences of bankruptcy, devoid of the trappings of legal and administrative traditions that characterize Western European bankruptcy regimes and their progeny in Africa and Asia. A second benefit of this recent wave is that as the former Soviet Union had no market related legislation of any kind, reform bankruptcy laws had to be considered in relation to all other aspects of commercial legal reform. This again reinforced the preeminence of economic factors in analyzing bankruptcy laws. Hence it is no surprise that simultaneous civil code and bankruptcy reform has resulted in not dissimilar laws focused on economic factors in such culturally diverse countries as the republics of Georgia, Mongolia, Kazakhstan, Armenia and Turkmenistan.

How does this attention to economics translate into a reform bankruptcy law? What kinds of provisions is the international financial community now looking for in a reform bankruptcy law? With Western assistance, the Ministry of Justice for the Republic of Armenia in late January of 2000 tabled and publicly disseminated for analysis a reform bankruptcy law. Let us examine the answer to these questions in the context of the prospective and retrospective characteristics of bankruptcy reform legislation and where in the reform process Armenia stands at the moment. Prospective bankruptcy provisions are those that enable all economic actors to understand what will happen in the event of a bankruptcy filing. As respects the prospective operation of bankruptcy, the Armenia draft has the following prominent characteristics:

- clear indication that the purpose of bankruptcy is prospective – the discharge of the debtor, not the extraction of punitive measures or the advancement of a state social agenda
- clear guidance to the layperson in business as to how to commence bankruptcy proceedings, including specific reference to the types of documents required for filing, rather than reliance on local judicial tradition or vague statements as to court procedure

Of course, bankruptcy also has the element of putting a disorderly economic house in order and consequently has a retroactive effect, meaning it takes into account the reality of existing debtor obligations. Among the prominent aspects of the Armenia draft with these characteristics are those offering:

- precise instruction as to differences among creditors and how each type of creditor sets forth the grounds for a valid claim and then has a forum for articulation of position once bankruptcy has begun, rather than provisions simply leaving bankruptcy in the hands of the court

- clear objective grounds for setting aside transfers made by the debtor prior to any filing in bankruptcy, rather than standards focusing on bad faith or ill intent by the debtor with accompanying punitive measures

Of course, no one expects Madagascar, or any other country, to follow an Armenian model. And that is the point – there is no model. Rather than a prototype, Armenia is following a general worldwide trend. Is Armenia’s proposed direction emblematic of recent trends? In the legal sense, for the reasons mentioned above as to the reform direction in civil code countries, it is. But Armenia is representative in an even deeper sense. In terms of the relative importance of the private sector, the most recent transition report for the European Bank for Reconstruction and Development places Armenia almost exactly in the middle of the collection of the 26 countries in Eastern Europe and the former Soviet Union having civil codes. With private sector share at 60% of GDP, Armenia is just at the point of developing laws to accommodate the needs of an expanding private sector. Of course, Madagascar is more deeply rooted in the private sector tradition. But it similarly needs to develop laws sensitized to a private sector that will be growing not only in size but sophistication due to proposed privatization efforts. This means greater sensitivity to the economic factors exemplified in the prospective and retroactive characteristics of bankruptcy as set forth above.

Again, Eurasia has provided the most recent model for bankruptcy reform in transitional economies. Even in Belarus, in many respects the least progressive of the European republics of the former Soviet Union, there has been significant reform legislation since 1991. The Belarus law contains no trace of penal provisions. It favors economics. It has minimal discussion of procedure. Instead, it features the active participation of economic constituencies like creditors in the bankruptcy process. It is a “user friendly” 41 articles. See Law “On Economic Insolvency and Bankruptcy,” Republic of Belarus, May 30, 1991. If this former Soviet economic backwater can do as much to advance bankruptcy as a progressive and retroactive determination, surely Madagascar can surpass it in terms of conformity to these criteria and in terms of accountability to the business community.

2. Comprehensiveness

This aspect of bankruptcy proceedings emphasizes ease of understanding the law and access to the courts system. To be the definitive arbiter of capital resources when a firm faces problems, a bankruptcy regime must offer access by all constituents of a country’s economy, from the smallest firm to the major international corporation. As the most complex economy in the world, it is only appropriate to briefly examine bankruptcy reform in the United States to see how a bankruptcy regime can be more open to the needs of different economic constituencies. Bankruptcy reform in the United States was undertaken beginning in the late 1970s, at a time when the American economy shared many of the same general types of problems as that facing Madagascar, albeit to a different degree. Among these characteristics were: industrial inefficiency and the need to introduce competition to basic service industries to benefit consumers, severe disintermediation in the financial sector induced by significant inflation and, finally, significant consumer and firm indebtedness coupled with low savings rates. American

reform was driven by economic necessity, not jurisprudence. Comprehensiveness was achieved by bringing bankruptcy closer to all aspects of the economy as follows:

- reducing consumer and firm indebtedness through provisions in the reform law demonstrating clear commitment to discharge of indebtedness as the reason for bankruptcy, thus encouraging voluntary filings in bankruptcy and accelerating the efficient use of capital
- encouraging both prudent lending by banks and public confidence in saving as an economic tool through provisions in the reform law recognizing precise differentiations among creditors, particularly among secured and unsecured creditors, on the basis of risk
- arresting inflationary trends by reallocation of capital from inefficient firms to efficient ones through such provisions in the reform law as those related to conclusive and legally binding lists of creditors and identification of the precise moment of final action by the bankruptcy court

Again, such reforms as were undertaken were not rooted in either the Anglo nor American legal systems. Rather, they were demanded by economics and the need to tie the law to modern commercial realities. The American search for comprehensiveness and accommodation to modern commercial realities has paid off handsomely: in a time of great economic prosperity, American bankruptcies are at an all time high and have succeeded in effecting reasonably quick and transparent reallocation of capital from inefficient to efficient firms to spur an unprecedented sustained American economic boom.

As the American reform was dictated by economics rather than adherence to Anglo legal tradition, it is no surprise that its northern neighbor, with a pedigree in both the common and civil law traditions, has followed suit. Canada has in fact recently significantly revised its bankruptcy law. Economics rather than cultural tradition has led it to expand possibilities for discharge of debtors, with mediation to effect discharge a last resort in case of complication. See amendments to “Bankruptcy and Insolvency Act,” June 19, 1998. Again, discharge is at the heart of bankruptcy legislation as a modern commercial tool.

In summarizing state of the art international practices and standards in bankruptcy, Malagasy jurists and economic policy makers should know that bankruptcy reform has entailed close cooperation between local governments and donors of different legal traditions. Lawyers from both the civil code and common law traditions have worked side by side to produce reform bankruptcy laws that effect a marriage of civil code in form and economic policy in substance.

American and German lawyers have worked particularly closely in setting this new standard, as Malagasy and other professionals have been learned through the international community. La Restructuration des Entreprises en Difficulté, IDLI/USAID Forum, 12-16 décembre 1994, p.p. 4-5.

The prospective and retroactive character of bankruptcy as well as its comprehensiveness yield four essential policy principles for the evaluation of any bankruptcy regime:

- The need for a bankruptcy law that expands the number of economic voices and minimizes the number of administrative ones (comprehensiveness)
- The need to provide for resource allocation that is efficient rather than punitive (prospective operation)
- The need to facilitate economic calculations by setting forth concrete standards for each step in the bankruptcy process (prospective and retroactive operation)
- The need to confine bankruptcy's social goal to efficient resource allocation (prospective operation and comprehensiveness)

It now remains to evaluate the current Malagasy law on bankruptcy on these bases.

IV. EVALUATION OF CURRENT MALAGASY LAW

Using the criteria listed above, a summary review of the present law on bankruptcy, enacted in 1962, is as follows:

- *The need for a bankruptcy law that expands the number of economic voices and minimizes the number of administrative ones* - This means encouraging the prime economic actors in bankruptcy to participate. Article 437 of the present law fails to do this. It places the burden on debtors to file without sufficient economic incentives. No one disagrees that economic transparency is furthered by debtor filings. But this can only occur if the debtor is given economic grounds for doing so. This is provided by one easy solution: an unequivocal commitment in the law to discharge of the debtor as the goal of bankruptcy.

As to creditors, the present law does take account of economic reality by acknowledging that different creditors may occupy different positions. Chapter VI, Sections III and IV of the present law are examples of a general recognition of this principle. But more emphasis should be placed on creditor participation in the bankruptcy process. The special interests of classifications of creditors, for example, might be reflected in the development of a plan for the rehabilitation of the debtor. An elaboration of these and related points in a bankruptcy law both provides creditors an additional incentive to participate and will diminish chances of untoward, private deals between one creditor and the debtor and, of course, fraudulent transfers.

- *The need to provide for resource allocation that is efficient rather than punitive* - Article 437 forces the debtor to file bankruptcy in the event payments cease. Similarly, Article 614, with its many parts, punishes parties who are bankrupt under

stipulated conditions. The Article makes clear that punishment will be exacted for stipulated bankruptcy offenses that are simple and fraudulent. Moreover, discipline is tied to the bankruptcy regime rather than outside it.

Collectively such provisions extend the bankruptcy process beyond its proper reach of ensuring maximum economic efficiency. Articles 437 and 614 attribute legal significance to non-payment on the part of the debtor. Yet, this confuses a moral purpose for an economic one. There is a vast difference between the inability and the unwillingness to pay. The law generally should deal with both – but bankruptcy law should only deal with the former. Mere failure to pay under the text of Article 437 could attest to a number of circumstances, from a petty dispute between commercial entities to a *bona fide* disagreement over the terms of a complicated commercial agreement, neither of which has a bearing on firm efficiencies or the general capacity to satisfy obligations. Thus, the requirement of Article 437 that the debtor file due to a failure to pay merely invites disregard for the bankruptcy law and has a corrosive effect on its ability to efficiently allocate societal resources. Fortunately, the present law does provide the solution. Unfortunately, it does not advertise it. In accordance with the terms of Article 607, a bankruptcy law should give a clear and unequivocal signal that bankruptcy has but one primary goal: the discharge of the debtor, with exceptions to this specifically and narrowly defined.

Bankruptcy is not used in Madagascar for a simple and understandable reason: the law contains so many punitive measures that the debtor dare not file. As the law is not used, creditors perceive no advantage in filing, each seeking to exact its own concession from the debtor privately. There is something to be said for informal one-on-one resolutions of indebtedness in Madagascar. However, the price of this informality is often a series of temporizing maneuvers to keep a business afloat and play one creditor off against the other as inefficient business practices are perpetuated. The present punitive provisions in the bankruptcy law merely invite evasion and undermine public confidence in the role of bankruptcy to efficiently allocate resources. Who loses? Society generally, through the protracted deployment of economic resources that could otherwise be allocated to firms having a greater potential to offer jobs and expand consumer choices.

- *The need to facilitate economic calculations by setting forth concrete standards for each step in the bankruptcy process* – A bankruptcy law ideally gives clear signals as to the path to various “ports of entry” into a complex judicial process. It should be clear to make easier oftentimes very difficult economic and business judgements by debtor and creditor alike. Articles 437- 53 are designed to provide some guidance to the debtor in these regards while Articles 508-35 aim to provide guidance for creditors. But the law does not adequately facilitate calculations on either side of the equation. Aside from the punitive quality of the law, discussed *supra*, there is little to guide the debtor as to when to file. Surely the law cannot be literally read to mean any failure to pay requires a bankruptcy filing. Were this true, parties exercising legitimate contractual remedies would be penalized with the requirement they file bankruptcy. Then what can the law mean? Local jurists tie it to an objective criteria related to the financial health of the firm. Yet there are many such criteria, negative

net worth being one and declining cash flow being another, that might support a filing. But the importance of these vary with the firm. Again, the solution to defining a “port of entry” into the bankruptcy system for the debtor is to provide an incentive, not discipline. That incentive is provided by an unequivocal statement that discharge is the goal of bankruptcy, not adherence to some vague and unstated standard of the debtor’s financial condition that is difficult to police – and which the law itself does not enunciate.

Creditors fare little better. They too face difficulties making economic calculations under the present law. As noted repeatedly above, a bankruptcy regime derives its credibility largely from its comprehensiveness. This means its ability to conclusively and neutrally dispose

of creditor interests. But, especially given the demonstrable lack of trust by the business community in the Malagasy bankruptcy regime, the system’s credibility depends on its ability to convince each creditor that such disposition is fair and covers all creditors. This means giving creditors a panoramic view of the debtor’s relations with other creditors. Yet, the primary if not exclusive emphasis of Articles 508-35 is definition of creditor interests as to the court, not as to the business community at large. Despite all the procedures listed in these articles, there does not appear to be a clear reference to a legally binding final list of creditors on which to make business decisions. Finally, the present law does not uniformly and consistently differentiate among creditors. At times, certain provisions such as Chapter VI, Sections III and IV differentiate among creditors; at other times, as in consideration of the reorganization plan (“concordat”), there is no differentiation whereas the terms of such plan might carry significant interests for secured creditors. This lack of consistency gives uneven guidance to creditors seeking consistency in a law so as to weigh options.

- *The need to confine bankruptcy’s social goal to efficient resource allocation* - For the economic reasons stated in Part II *supra*, it is especially important that Madagascar structure a bankruptcy regime that is focused on the prompt disposition of assets. The problems with punitive and even penal aspects currently associated with the bankruptcy process have been reviewed *supra*. The current regime appears to mix the role of penal and regulatory authorities outside the court, such as the Public Ministry, with matters before the bankruptcy court and even the syndic. Articles 469 and 614 suggest this. This mixture of penal and civil responsibilities to achieve overall public aims merely diverts resources from the true aim of bankruptcy. Again, penal and larger social concerns with debtor behavior are best dealt with by the law enforcement officials and social welfare agencies best left to handle them, not with institutions such as the trustee.

The comments above are made early in the fifth decade of a Malagasy bankruptcy law that has not assisted the economy. It is time for a review of the current bankruptcy law, not only in terms of its ability to capture modern ideas, but in terms of its ability to marshal those ideas to serve the needs of the Malagasy economy generally. The points made above are not intended as exhaustive and all merit much elaboration. Still, it is hoped that they might guide the critical and careful examination needed, not only by

jurists, but by government decision-makers and the private sector as well. Only in this way can Madagascar develop a reform bankruptcy law whose distinguishing hallmarks become prospective and retroactive operation and comprehensiveness that can benefit the entire economy.

**THE NATURE AND STRUCTURE OF A REFORM BANKRUPTCY LAW
FOR MADAGASCAR**

7 April 2000

I. EXECUTIVE SUMMARY

Since last year, the Commission de Réforme du Droit des Affaires (CRDA) has undertaken a comprehensive review of the adequacy of the present law “On Bankruptcy and Judicial Regulations, on Rehabilitation and on Bankruptcies and the Matter of Bankruptcy Violations”, enacted in 1962 (referred to as BL). In response to specific requests, the ARD/Checchi/JURECO project has employed international standards to produce a commentary of February 23 on the “Projet de Loi Portant Organisation des Procédures Collectifs d’Apurement du Passif” (referred to as the January 10 draft) and an overall analysis, dated March 28, 2000, of the importance of bankruptcy reform and the key policy principles for a reform bankruptcy law.

The CRDA has now requested a synthesis of these two reports. But, as per direction of the CRDA, this synthesis is to be of a different nature. It is to be in the form of a directed, “action” oriented analysis rather than a mere commentary. This plan of action would represent the implementation of the key policy principles in the analysis of March 28 to the end of achieving a significant revision of the draft bankruptcy law dated January 10. This plan of action gives specific direction on the content of a simplified revised text useable by judges, lawyers and above all businesses, the end users of any bankruptcy law, alike.

To do a “fast forward” preview, this action plan is designed to yield a Law on Bankruptcy that is simplified and useable for its:

- ability to inform all parties in the first 4 articles why, where and how to file bankruptcy
- ability to communicate to creditors in 5 short articles how they can participate and hence how they gain by participation in the bankruptcy process
- ability to provide parties seeking to file a remedy in case of denial of access to the court system
- ability to instruct debtors and creditors alike in the first 6 articles how they can initially approach the court system to file bankruptcy *without the aid of an attorney or accountant*

What gave rise to such a populist impulse? The very request for such a synthesis on the part of CRDA is significant. It seems to reflect CRDA agreement with the common theme of each of the two ARD/Checchi/JURECO communications to date. This common theme is that four key principles should underline a reform bankruptcy law:

- The need for a bankruptcy law that expands the number of economic voices and minimizes the number of administrative ones
- The need to provide for resource allocation that is efficient rather than punitive
- The need to facilitate economic calculations by setting forth concrete standards for each step in the bankruptcy process

- The need to confine bankruptcy's social goal to efficient resource allocation

As was made clear in the analysis of February 23, the draft of January 10 seems not to have been drafted with these four principles primarily in mind.

At the same time, the effort to produce the draft of January 10, including that of JURECO advisers focused on domestic as opposed to international legal standards, is to be saluted. Much of this work should and, we are convinced, will find a home in Madagascar's general legal regime. But much of it does not belong in a simplified, reform bankruptcy law that must communicate directly to the Malagasy business community.

Phrased more plainly, the draft of January 10 succeeded admirably in raising questions related to bankruptcy that should be addressed explicitly in some legal text. But because of their complexity or lack of immediate relevance, many such questions should not be addressed in a reform law having as its most urgent task efficient capital allocation and therefore having its most important attribute immediate usefulness to the Malagasy businessperson or creditor of average sophistication. At the same time, this analysis has no intention of overturning the structural or institutional bases of the current Malagasy system. All necessary means are taken to preserve the remedial nature of bankruptcy and creditor's rights proceedings, which are aimed at rehabilitation as well as liquidation. Issa Sayegh, Introduction to OHADA, in Collaboration with the Secretariat of OHADA. A thumb nail appraisal of the January 10 draft is as follows:

- normative considerations - This includes such questions as: what is the purpose of bankruptcy? how can debtor and creditor most meaningfully participate in the process? does bankruptcy exist mainly for judges and court clerks or for the overall economic progress of Malagasy society? A final question is whether the bankruptcy process should be burdened with every grievance a creditor has against the debtor, especially those grievances that relate not to economic but to ethical lapses. As will be made apparent, the January 10 draft is most deficient here. It does not answer these questions in the interests of economic efficiency
- structural considerations - This includes the various general solutions to issues of insolvency, such as a anticipatory action to prevent debtor insolvency ("règlement préventif"), workout plan ("redressement"), liquidation, debtor rehabilitation ("cas de réhabilitation") or other means. It also includes the various legal institutions existing under the Continental tradition in place to effect these solutions, such as the clerk of court ("greffier") and authorized auditors. Here, the January 10 draft is at its strongest. To repeat: this plan of action for a new draft of a bankruptcy law to supplant the January 10 draft has no intention of disturbing either these solutions. Nor has it the intention of altering the means of effecting same through abolishing or qualifying the principal powers of officers in the traditional court system. In fact, it is hoped that this action plan, through the presentation of the Law on Bankruptcy *infra*, will strengthen such institutions through solidifying their connection to modern commercial trends.
- procedural considerations - This concerns the mechanics, rather than the policy, of the bankruptcy process. Here the record of the January 10 draft is mixed. It contains far too much elaboration on processes that most directly bear on relations between parties in the

judiciary such as the judge and the court clerk. These are of tangential consequence to economic concerns that should be the exclusive concern of bankruptcy. On the other hand, the January 10 draft occasionally contains too little elaboration on those procedural points that directly and immediately concern the businessperson. These concern the specifics of a bankruptcy filing, the formation of representative creditor committees and the like.

Taken in sum, the above three criteria support a bankruptcy system of three laws. The first is a law on bankruptcy that has as its sole aim the liquidation or reform of a firm exclusively on economic rather than moral or ethical grounds. The second is a law on creditor's rights and fraudulent conveyances which provides particular creditors with a civil remedy in case of specific breaches of obligation by the debtor. This law would not concern the economics of the debtor firm but be focused merely on alleged improper behavior. The third is a law that concerns the many in court processes attending bankruptcy that nevertheless only indirectly concern debtors and creditors. This third law, or a series of articles concerning these matters, is best left to the Code of Civil Procedure, rules of court or a separate law dealing exclusively with bankruptcy. The submitted suggested Law on Bankruptcy *infra* refers to this as a Law on Bankruptcy Procedure but intends to express no fixed preference for whether same should be a separate law, an addition to the Code of Civil Procedure or rules of court. Local specialists need to determine this.

In addition to keeping the focus of a bankruptcy law on economics, rather than policing debtor behaviors and the minutiae of court procedure, this tripartite breakdown of laws offers an additional advantage of immense value to the Malagasy business community: simplicity. As the topic of this action plan is bankruptcy, it will focus primarily on the first and to a lesser extent the third of these reform laws. It will briefly discuss the place of a separate law on fraudulent conveyances.

II. STRUCTURE OF A REFORM BANKRUPTCY LAW

A. Proper Use of Presented Text

The draft text for a reform Law on Bankruptcy presented in Part II B *infra* may appear a novel if not radical departure from both the BL and the January 10 draft. But this only appears so without a consideration of how the proposed reform Law on Bankruptcy was composed. In fact, the draft text proposed below features the intersection of the four key principles for a reform bankruptcy law with both current Malagasy business practice, on one hand, and Malagasy legal tradition on the other. It is not just that economic policy may dictate one determination and legal tradition another. It is that the current "tradition" relative to bankruptcy is legal, and only that. In fact, the BL is not used in business practice. And without business practice, there is no real tradition in a commercial law to defend.

This is not to suggest that Madagascar's legal community abandon the Malagasy legal pedigree in considering a reform bankruptcy law. However, it is to suggest that Madagascar first focus on how a bankruptcy law can function as a vital economic tool in the current economic environment. Without this, no true tradition can develop. Substance must come ahead of form. But form cannot be entirely abandoned.

It is with such balancing in mind that the draft Law on Bankruptcy below was produced. An analysis of the January 10 draft with these principles in mind does not by any means lead to a discarding of that effort. It does, however, lead to a questioning of the two thematic “p’s” prominent in the January 10 draft: procedure and punishment. The presentation of the draft text below is a result of the application of a balance of concern for economics and tradition. This balancing has supported the conclusion that a reform bankruptcy law is most effectively advanced minimizing the procedural and penal aspects of the January 10 draft. Otherwise, as will be amply demonstrated below, the January 10 draft has proven an excellent resource as a basis for the drafting of a more simplified law. Its substantial impact on the draft Law on Bankruptcy presented in Part II B might be reduced to the following equation:

Reform Law on
Bankruptcy = January 10 draft - procedural considerations - penal characteristics
(largely draft Articles 2,8,29-38, (largely Title V)
52-66 bis, 78-90, 119-93
200-02, 208-14 215-25)

Does this mean that the procedural and penal aspects of the January 10 draft should be abandoned? Hardly. To the contrary, as discussed in Part III A *supra*, the procedural aspects of the January 10 draft are best given voice in a Law on Bankruptcy Procedure. Further, as discussed in Part III B *supra*, the penal aspects of the January 10 draft are best accommodated by civil courts through a Law on Fraudulent Conveyances.

The non-penal substantive Articles of the January 10 draft provided a large part of the core for Drafting the Law on Bankruptcy presented below. Such changes as are made are largely in the interests of simplification and reprioritization so as to accommodate the likely focus of the local business community. Further, there are salutary innovations of the January 10 draft, particularly those respecting rehabilitation (“cas de rehabilitation”), workout (“redressement”) and prevention of debtor default on indebtedness (“reglement preventif”). The draft Law on Bankruptcy borrows on these and in some ways extends their reform impulse.

In short, the January 10 draft is to be at once put to the side but kept close at hand. The aim is both a thorough but more useable legislative product.

B. Presented Product

The analyses below are largely constructive elaborations upon the advice given by ARD/Checchi/JURECO as per USAID by reports dated February 23 and March 28. The word “constructive” is used in that the former report was largely a reaction to the January 10 draft while the latter set forth some bedrock concepts relative to bankruptcy. Where possible, a brief explanation will be provided for the rationale underlying the presentation of an Article or series of Articles. Such explanations, along with citation to articles in the January 10 draft and other authority, are provided at the conclusion of each Title with its suggested articles. This is done so as to preserve the thematic unity of all articles to each Title. The plan by all means intends to make use of the January 10 draft as a resource, but will also make use of the reasoning developed in the February 23 and March 28 commentaries.

Finally, while large elements of the January 10 draft are incorporated, the organization set forth below attempts to be in sequential order. This is in the interests of the end user of the legislation, who is apt to wish to locate the most important concepts and the earliest stages of the bankruptcy process in the beginning of the legislation.

The following is the outline of the text for reform legislation entitled a “Law on Bankruptcy”:

Title I. PURPOSE AND SCOPE OF BANKRUPTCY

Article 1 – This Article should establish discharge in of the debtor’s indebtedness, in whole or in part by means of:

- (a) A workout plan with or without liquidation as provided in Title IV
- (b) A remedial plan for business continuation without liquidation as provided in Title V

as the aim of a filing in bankruptcy.

The Article should additionally identify the debtor and a “significant group of creditors” as parties that may effect either filing. The significant group of creditors might be defined at the moment of filing in terms of:

- (a) absolute monetary amount relative to debtor’s capitalization or asset size as publicly declared
- (b) a certain number of secured creditors of the debtor

Article 2 This Article should establish a narrow range of business entities that do not qualify for bankruptcy. Typically, these would include quasi-governmental monopolies and entities such as hospitals, clinics and other concerns directly tied to national security or health.

Article 3 This Article should set forth the type of individual or business that is disqualified from filing as a creditor under Article 1 *supra*. The core of this Article is the notion of a “controlling person” – i.e. a business entity with such a close connection to the debtor as to be disqualified from official status as a creditor. Such persons precluded from the status of creditors for purposes of filing might be individuals or moral persons who are, or who have relatives by blood, marriage or adoption, who are:

- (a) employees, officers, directors or managers of the debtor
- (b) parties having a direct or indirect equity or partnership interest in the debtor’s estate that equals or exceeds a certain percentage (e.g., 5%)
- (c) parties having the option through management contract or other device to purchase an interest in the debtor’s estate that equals or exceeds a certain percentage (e.g., 5%)
- (d) representatives, agents or employees of any party who is deemed a controlling person by the criteria (a) – (c) above

The Article should clarify that disqualification from being considered a creditor for filing purposes is not disqualification from being considered as a creditor.

Article 4 This Article sets forth the very few obligations that are not subject to discharge. Among the types of obligations that the law may wish to consider not subject to discharge are:

- alimony and child support payments,
- fines in connection with the commission of a crime
- taxes due as a result of proven tax fraud or evasion
- certain amounts owing as a result of judgements or determinations in civil cases including possibly, certain amounts egregious breach of duty as an employer (i.e. failure to fulfill obligations to make payments into pensions, health insurance plans, etc.)

The Article should make clear that upon evidence of same, the only responsibility of the bankruptcy court is to inform the necessary civil court, law enforcement authorities or social welfare agency.

Rationale of Title I: From the outset, the business is assured that the goal of the bankruptcy process is economic and not penal or the advancement of social causes. These initial brief suggested Articles set forth the preeminent policy reason for bankruptcy: economic efficiency. They also set forth the very few public policy constraints on bankruptcy to achieve this purpose. Suggested Articles 2 and 4 do this on both the level of economic sector and firm level, respectively. Finally, suggested Article 3 *supra* is preventive, not penal in nature, consistent with the need for a reform bankruptcy law that focuses on economic efficiency.

Citations to Title I: Suggested Article 1 has some basis in Articles 53 and 204 of the January 10 draft as well as Article 607 of the BL. Suggested Article 3 is designed as a simple solution to the problem of fraudulent use of the bankruptcy process to further ends prohibited under in Articles 228-29, 231 and 237 of the draft of January 10. But it is preventive, not penal in nature. Suggested Article 4 finds its basis in general public policy as in effect in many jurisdictions and in such provisions as Articles 541-45 of the BL.

TITLE II. FILING IN BANKRUPTCY

Article 5 This Article should set forth precisely how a debtor should file and where in order to achieve either discharge or significant firm reorganization. In addition to setting forth the proper courts of bankruptcy jurisdiction by region and the precise relation of the court to the debtor (i.e. the court where debtor is located or has done much business, etc), the Article should stipulate precisely which documents are filed with the court to achieve a filing. The documents should not require the debtor to engage an accountant or lawyer, but should be as simple as possible, requiring only:

- a balance sheet or the equivalent thereof, effective as of either (i) the date of filing, or (ii) the date debtor could not make payment on documents of indebtedness
- such documents of indebtedness as the debtor submits

Finally, this Article should stipulate that the debtor may elect at the time of filing what the aim of the filing is - discharge and liquidation or reorganization.

Article 6 This Article should repeat the basic elements of Article 5 but in fact covers a filing by a creditor or group of creditors rather than the debtor. Presumably, issue of where a creditor files is governed by either the place of business of the debtor, or the place of performance (i.e., where debtor should have paid the indebtedness). Simple documentary requirements for creditors are:

- such documents of indebtedness as the creditor submits
- in lieu of documents of indebtedness, a simple statement signed by the creditor or creditors as to the conditions giving rise to debtor's indebtedness and debtor's failure to perform on each obligation alleged
- a separate signed statement if the filing is by one creditor that the creditor has made two demands upon debtor for payment due following the indebtedness or that the indebtedness is secured under law, along with written evidence of such security

In addition to this last documentary requirement, which imposes somewhat of a practical limit on creditor filings, this Article might also contain a legal limit on creditor filings. Consideration should be given to prohibiting creditor filings in bankruptcy when the amount in question is less than the greater of: (a) 5,000,000 FMG or (b) one half of the debtor's required amount of stated capital, if required by law.

Article 7 This Article should stipulate that a party has officially filed in bankruptcy on the date the court clerk (or "greffe") affixes a seal with date on same documents. The Article should go on to provide that the greffe is bound to provide the party filing papers with a copy of each document under seal, free of charge. The Article should stipulate that the greffe is duty bound to accept all documents submitted for filing by a debtor or a creditor and to certify by seal that each has been received and that there is no charge, officially or unofficially imposed, in connection with the filing. This Article should prohibit the greffe from affixing a stamp on any document without affixing it on all others. The only grounds the greffe has to refuse formal filing of documents are:

- documents that are illegible or damaged on their face
- documents missing pages

This Article is to make clear that the responsibilities of the greffe are purely ministerial and not discretionary – i.e., that the greffe is to make no judgement as to the legal effect or import of the documents filed.

This Article will conclude by stating that Appeal of the greffe's failure to stamp documents lies with the Procurator of the Republic ("Procurateur de la Republique").

Article 8 This Article should stipulate that upon filing to achieve a workout along with possible liquidation, there is a complete suspension – or “stay” of action’s against the debtor’s estate by any particular creditor or group of creditors. A filing to achieve a rehabilitation plan should have the same effect.

Article 9 This Article should clarify the relation between the legal significance of filing and the opening of the collective procedure (“ouverture d’une procédure collective”). This Article should specifically set forth concretely what the procedure of “ouverture” adds to the legal rights and responsibilities of the parties that are not provided by simple filing. This Article should also signal whether “ouverture” has significance that is limited to workout and liquidation or whether it applies as well to the formation of rehabilitation plans.

Rationale to Title II: Again, the goal is a draft law, the first two pages of which inform debtors and creditors why, how and where they begin proceedings in bankruptcy. Documentary requirements in suggested Articles 5 and 6 are made as simple as possible. This is for the obvious reason that to encourage debtor filings, the law should not impose elaborate requirements that would require a debtor to engage a lawyer or an accountant. Nor should creditor filings be complicated; creditors may in fact have little information available about the debtor due to lack of access. However, there should be some limit on creditor filings, especially those by one creditor, in order to avoid frivolous and vindictive filings. Like suggested Article 3 *supra*, the emphasis of suggested Article 6 is on prevention, not punishment, in bankruptcy filings.

Suggested Article 7 is designed to state clearly when a bankruptcy case begins for legal purposes. This means reference to a concrete event that the businessperson can understand, like affixation of a seal on papers, not reference to a legal theory as to when something begins. Both BL and the January 10 draft are unclear in this respect. The rest of suggested Article 7 has no analogue in BL or in the January 10 draft. Yet, the potential for delay in bankruptcy proceedings, and hence delay in economic efficiency, due to administrative inaction or misconduct is immense. Suggested Article 7 is designed to remove such barriers and to provide a remedy in case of complications. Suggested Article 7 reflects an instance when an articulation of procedures is of vital interest to the business person and should be in the text of the substantive law on bankruptcy. Consistent with the overall philosophy of encouraging filings in bankruptcy to achieve economic efficiency, suggested Article 8 reinforces filing, not the debtor’s failure to pay, as the key event that triggers a suspension of creditor actions against the debtor. The January 10 draft gets to this idea but only belatedly in Article 75.1

Suggested Article 9 is essentially a call for clarity as to the importance of “ouverture” in the case of collective procedure. Bankruptcy experts in Madagascar need to clearly articulate why “ouverture” is important and what it adds to the protection of debtors and creditors that simple filing does not provide, given the “stay” provided for in suggested Article 8. As with suggested Article 8, the issue of when something like “ouverture” has legal effect needs to be tied to physical evidence, a recordation, the creation of a document, etc. Without such tangible evidence, the businessperson is lost in legal jargon. If it is limited to workout plans coupled with liquidation, then suggested Article 9 should so clearly state. Suggested Article 9 should plainly state that “ouverture” marks the commencement of the agreement among creditors for a

disposition of assets (“concordat”) referred to in Article 28 of the January 10 draft. If it has implications beyond this, suggested Article 9 should so state.

Citations to Title II: Suggested Articles 5 and 6 find their basis in BL 438 as to the documents required. This is a simpler statement of documents than that in Article 26 of the January 10 draft.

The reference to appeal to the Procureur in suggested Article 7 finds its basis in BL Articles 486, 614. If this officer of government can intervene in cases of complication with the development of a plan for rehabilitation, surely this officer should intervene in favor of a party seeking relief through bankruptcy proceedings.

Suggested Article 8 is meant to emphasize as the prime consequence of a filing in bankruptcy the protection of the debtor’s estate rather than the cessation of debtor payments or the administration of the debtor’s estate by the trustee (or “syndic”). Important though these features may be, they are of secondary importance to the overall goal of debtor protection and are really secondary consequences of court protection of the debtor estate. In this sense, suggested Article 8 is intended to supercede such provisions as Articles 27, 33, 33.1 and 52-65 of the January 10 draft. Finally, suggested Article 8 communicates to the businessperson a key idea about bankruptcy not clearly discussed in the January 10 draft until Article 75.1. The idea is debtor protection from creditors through bankruptcy. As to suggested Article 9, there is a clear need to cover the central significance of “ouverture” and concretely when it occurs. Suggested Article 9 therefore should take care of most if not all substantive and important points made in Articles 28-38 of the January 10 draft.

TITLE III. CREDITOR RIGHTS AND INVOLVEMENTS

Article 10 This Article should clarify how a creditor attests to creditor status that is how a creditor makes “proof of claim.” This accomplished by having the Article provide that upon “ouverture” for a workout plan with liquidation, the court will superintend the publication of “ouverture” and clearly communicate to all creditors the need to file within 60 days of such publication. The Article should make clear that all classes of creditors will be closed upon the expiration of this 60 day period, absent the following extraordinary circumstances:

- willful fraud or deception by the debtor during such 60 day period under circumstances such that the creditor could not have had actual notice of either the bankruptcy filing or the “ouverture”
- the creditor has a claim not subject to discharge under Article 4

Article 11 This Article will treat the crucial issue of why and how different classes of creditors are formed. This Article will provide that:

- creditors having the status of secured creditors under law will form one class

- creditors other than secured creditors may form more than one class and are entitled to recognition as separate classes provided that: (i) two-thirds of such unsecured creditors in total approve of the division into more than one class; (ii) there is an economic basis for such division, as evidenced by unsecured creditors having claims based on the performance by a certain aspect of the debtor's business or as evidenced by unsecured creditors having claims against the debtor that will arise at the same time; and (iii) no single unsecured creditor or group of creditors representing at least one-third the value of the total amount of unsecured claims presents a case that such a division will do undue injury to any group of creditors. The Article will provide that the bankruptcy court shall review criteria (ii) and, in the event of a challenge under (iii), hear the merits of a case.

Finally, the Article will provide that, whatever the determination of the court on the issue of a division of classes among unsecured creditors, such determination shall be appealable to the commercial tribunal ("tribunal de commerce"). Such appeal may include an appeal of any determination made by the class of unsecured creditors challenged or any representative of same by trustee ("syndic"). The Article will conclude that such an appeal will in no way delay continuation of bankruptcy proceedings, the formation of the syndic or other ordinary dealings in a bankruptcy case.

Article 12 This Article needs to be addressed specifically to the formation and powers of the syndic. The Article needs to formulate that a syndic or syndics shall be formed by the court within 30 days of the close of the classes of creditors under Article 10. The number of syndics shall be determined by the number of classes of creditors established under Article 11. This Article shall provide that the syndics shall share responsibility on all matters except as to the care and maintenance of secured property, which will be the primary responsibility of the syndic representing secured creditors. The Article will provide the general responsibilities of the syndic as follows:

- general administration of the debtor's estate, including but not limited to monitoring the value of same
- preservation of the estate for the benefit of all creditors and the debtor
- representation of the interests of creditors in the formulation of work out plans, including those featuring liquidation of the debtor's assets, and rehabilitation plans, whether formulated or proposed by the debtor or creditors
- sequestration of property of the debtor as necessary to protect the physical condition of same or to secure same from creditors
- processing and recognition of creditor claims after closure of the class of creditors under Article 10

The Article will provide that disputes among syndics shall be resolved in accordance with Article 13. The Article will provide that all syndics shall be held to a standards of diligence and fidelity

to the fair administration of the interests of the debtors and the creditors in accord with law, including the common law (“droit commun”).

Article 13 This Article will provide for the initiation and resolution of disputes among the creditors and between the creditors or the debtor and the syndic or between syndics. It should stipulate that no such legal actions can begin absent initiation by a party in interest. It should further stipulate that legal action by against a class of creditors will consist in legal action by or against the syndic as the representative of same. The Article will stipulate that a court in bankruptcy will hear the action provided it is based on a duty imposed under this bankruptcy law. The Article will also provide that all such decisions, as well as all actions by of the court in bankruptcy, shall be subject to appeal to the tribunal de commerce.

This Article should go on to provide that the bankruptcy court has the obligation to refer to the tribunal de commerce any possible legal action not the subject to this bankruptcy, but nonetheless related to creditor rights against the debtor or any related matter, including but not limited to those related to fraudulent conveyances discussed briefly *infra*. The Article will make clear that while the court in bankruptcy has this responsibility, nothing in this Article will be construed to compromise the stay of proceedings against the debtor set forth in Article 8.

Article 14 This Article will set forth the three principles as to transfers by the debtor after a filing in bankruptcy. Such transfers are invalid:

- (1) if made and not approved by the court in bankruptcy subsequent to the filing and prior to the operation of the syndic;
- (2) if made and not approved by the syndic subsequent to the formation of the syndic under Article 12;
- (3) if made prior to or following a filing in bankruptcy, if such transfers are made:
 - from the debtor to a controlling person of debtor as defined in Article 3
 - at any time within 90 days of the filing in bankruptcy by any party or subsequent thereto
 - not in exchange for contemporaneous value – that is that the transfers are not for value given by the controlling person at the time of the transfer

Article 14 should then stipulate that the bankruptcy court has, and is obligated to exercise, full judicial authority to effect repossession by the creditors through their syndics, which measures will include but not be limited to replevin, attachment and garnishment, freezing of bank accounts and all other means of repossession.

Article 15 This Article should concern the lien status of the debtor’s estate and should stipulate that, upon filing, a lien is imposed in the name of the debtor’s estate in bankruptcy over all the debtor’s assets subject to security interests under law. This lien shall be exercised exclusively in favor of creditors *en masse* who have been accredited under Article 10. The Article will further state that the lien has super priority status in relation to all other liens held by creditors of the

debtor and that the syndic is obligated exercise same in the event of any attempt by a secured creditor to exercise rights against the debtor.

This Article should conclude that the existence of the lien hereunder will not be construed to give any single creditor filing an individual right such creditor did not otherwise have.

Article 16 This Article will treat special claims by certain creditors. Specifically, it will treat claims by lessors and tradesman. As to lessors, this Article will set forth how lessors may reclaim possession and use of leased real estate from the debtor who is subject to a filing in bankruptcy. The Article will provide that the lessee may submit evidence to retain possession provided the lessee or parties sponsoring a workout or rehabilitation plan can convince the court presiding over the bankruptcy that:

- the maintenance of the lease is essential to the continuation of such business as lessee has under a workout or rehabilitation plan
- lessee is able to make payments on the lease

Otherwise, the Article should provide that the court shall find for the lessor.

The Article will then go on briefly to handle claims by tradesman. Finished work or work in process not yet delivered to the debtor may be held and resold by tradesmen subject to the standard of commercial reasonableness in the droit commun.

Rationale of Title III: Nothing in the January 10 draft, including draft Article 78, provides clear guidance as to who superintends publication to creditors or as to when the classes of creditors are officially closed. Yet, these are key ideas for the business community. Suggested Article 10 aims at these goals.

Suggested Article 11, like suggested Article 7 on the filing and the greffe, contains no analogue in the BL or the January 10 draft. However, several portions of the January 10 draft, especially those mentioning the diverse claims of creditors under draft Articles 121 and 125, foresee different allocations on liquidation depending on the nature of a creditor claim. It is time for a reform bankruptcy law to recognize that the formulation of workout and rehabilitation plans are exercises in political and economic power. A reform law can accommodate this reality and make them orderly and transparent. Suggested Article 11 will thus increase the confidence of an otherwise cynical and skeptical business community and increase the possibility for creditor participation by accommodating the common interests of similar creditors.

Suggested Article 12 on the syndic is pivotal. The allocation of syndic responsibilities is largely a compact summary from scattered and diverse portions of the January 10 text. This clearer, simpler statement of the main syndic powers is in the interests of all concerned, including the business community. The January 10 draft makes continued reference to the syndic but contains in no one place a clear statement of the central concept (for example, among the first Articles of the January 10 draft mentioning the syndic is Article 33.1 but the central role of the syndic is not

stated until Article 72). What suggested Article 12 adds is elaboration on the situation in which more than one syndic is appointed. Suggested Article 12 is intended to provide direct instruction to the court as to the sensitive political issue of multiple syndics and the precise grounds for appointment of same, that being tied to the existence of multiple classes of creditors. By contrast, Articles 35 and 42 of the January 10 draft do not provide guidance on what should be a crucial issue of creditors rights and participation in the bankruptcy process. Additionally, suggested Article 12 differs from the January 10 draft by providing a specific time when the syndic begins functioning; Article 72 of the January 10 draft merely implies that the syndic will begin operation after “ouverture” without stating exactly when. In order to ensure that creditors will participate in the bankruptcy process, it is both necessary to assure them that they will be represented by the syndic and to provide when the syndic begins operation. Suggested Article 12 is a marked improvement in these regards.

Suggested Article 13 is designed to cover all configurations of dispute among the parties to bankruptcy but actions against the debtor, which are subject to stay pursuant to suggested Article 8. It is important to note, however, that the role of the bankruptcy court is confined to disputes pursuant to items in this bankruptcy law. This is to avoid both distraction and conflicts of interest. Consistent with several Articles of the January 10 draft, such as Article 129, appeal to a court other than the immediate court in bankruptcy is foreseen.

Suggested Article 14 in (i) and (ii) merely simplifies extremely complicated draft Articles 67-71 of the January 10 draft. Under such draft Articles, the contestability of debtor transfers depends upon such legal niceties as the nature of the property, the time of transfer, the manner of a payment or transfer and sometimes the relation of all three factors. This is entirely too confusing for the debtor, who needs guidance as to how business should be conducted. Suggested Article 14 (i)-(ii) provides the simple standard necessary.

Suggested Article 14 (iii) concerns the complicated policy issue of treatment of debtor transfers prior to the debtor’s involvement in bankruptcy. It is a compromise between the Continental and American models of bankruptcy. As Articles 67-71 of the January 10 draft make clear, some transfers made after the debtor’s failure to make payment may be invalidated. In Articles 228 and 231-33 of the January 10 draft statement, there is also a call to invalidate transfers to certain entities or in certain contexts as examples of simple or fraudulent “banqueroute.” The problem with this approach is two fold. First, it focuses unduly on such factors as intent and the punishment of conduct. Secondly, it rests largely upon the event of the debtor’s failure to make payments. But as pointed out in the commentary of March 28 and in the *Rationale for Title IV supra*, such a failure may have many reasons, none of which relate to the overall financial condition of the debtor. In contrast, the American approach is not to focus on the failure to make payment but on the neutral, legally operative event of filing in bankruptcy. The approach is preventive, not punitive. Without looking to the intent of the debtor, it assumes certain transfers are subject to challenge by the trustee in bankruptcy if they are made under certain circumstances prior to a bankruptcy filing. The goal is to prevent the debtor from manipulating a filing in bankruptcy by making questionable transfers to business cronies in prejudice of the general right of creditors. Suggested Article 14 achieves the Continental end of eliminating suspect transfers through the more American means of prevention, not punishment.

Suggested Article 15 clarifies several aspects of super lien status found in Articles 74 and 135 of the January 10 draft. It applies to personal as well as real property. Its coverage is also limited to the name of creditors accredited under Article 10. Further, the super lien is intended as passive – it is not intended to put all accredited creditors on even footing in the exercise of individual rights against the collateral. It rather directly addresses each accredited secured creditor, in stating that exercise of the rights of each is foreclosed outside the context of the overall bankruptcy proceedings. In this sense, it reinforces the stay of proceedings in suggested Article 8.

Suggested Article 16 on the claims of certain creditors is designed to simplify the present draft of January 10. That draft recognizes claims against the debtor by virtue of familial or employment status, particularly wage claims. Yet, both of these are handled by either providing that certain such claims are not subject to discharge, as set forth in suggested Article 4 *supra*, or have priority status pursuant to suggested Article 22 *infra*. The text of this suggested Article tries to accommodate the special needs of tradesman and lessors, as does the draft of January 10. The difference is that this suggested Article 14 deals with the claims of such parties from the paramount interest of economic efficiency: who is best equipped to deal with assets of real property or merchandise ordered, the debtor on one hand or the lessor or tradesmen on the other? By contrast, Articles 97-111 of the January 10 draft deal with legal distinctions such as lease cancellation and the subtleties of restitution of goods. These are more removed from modern commercial reality and less understandable to the person of business.

Citations to Title III: Article 78 of the January draft provides much of the basis for the thinking of suggested Article 10.

The right of appeal in suggested Article 11 has some basis in Articles 216- 25 of the January 10 draft which provide for appeal.

As regards suggested Article 12, various articulated responsibilities of the syndic have their basis in the following articles of the January 10 draft: general administration of the debtor's estate (draft Articles 48-49, 63), preservation of the debtor's estate (Articles 52 bis, 54), representation of the interests of creditors in the formulation of a plan (Articles 52, 119, 131-32, 137.1), sequestration of property (Articles 59-62), and processing and recognition of creditor claims (similar to Articles 79-80, 84). Suggested Article 12 does stipulate that the syndic be involved in valuation and accounting. Given the standard of liability imposed on the syndic, there is no reason why such a body could not assume the responsibility of accounting, thus avoiding the separate office of controller set forth in Articles 48-49 of the January 10 draft.

Suggested Article 15 extends concepts used in Articles 178 and 204 of the January 10 law but applies same to all varieties of property, personal as well as real.

Suggested Article 16 on special claims that might be made against the debtor is either handled by this suggested Article, suggested Article 4 on discharge *supra* or suggested Article 22 on

priorities *infra*. Collectively, these suggested Articles dispense with the possible conflicts between the debtor and other parties raised by Articles 91-111 of the January 10 draft.

TITLE IV. WORKOUT PLAN

Article 17 This Article will set forth that a workout plan may be developed between the debtor and a group of creditors when the debtor has been unable to meet financial obligations. The workout plan may provide or may not provide for liquidation. This Article will state that the goal of whole or partial discharge through whole or partial liquidation as articulated in Article 1 will be attained through a workout plan undertaken by the debtor, the creditors or both which provides for:

- repayment of all or part of indebtedness through liquidation
- continuation of all or a part of the business in question by the debtor under the direction of the syndic or creditors, as stipulated
- the extent of the indebtedness subject to discharge

Article 18 This Article will discuss the contents and execution of the workout plan. It will provide that a workout plan will have no preconditions and will be the product of open exchange among creditors and between the debtor and the creditor or classes of creditors. The syndic or syndics will administer execution of any plan. The Article will further provide that the plan may but need not include the transfer or assignment of any of debtor's assets to any party, including but not limited to any creditor or group of creditors or a syndic. The Article will provide for two mechanisms to ensure that the disposition of debtor assets in any workout plan is fair and self-equitable:

- use of open auction processes whenever possible
- bankruptcy court scrutiny of the terms of any workout plan including proposed transfers or assignments to any controlling person of the debtor, the creditor or a syndic, with the burden on any party contesting such assignments or transfers to establish that same suggest self-dealing by the debtor or creditors as evidenced by a substantial lack of conformity of the terms transfer or assignment when referenced against terms that might be reached in a market transaction, between parties dealing at "arm's length."

Article 19 This Article will provide that either the debtor, a creditor or a group of creditors, by class of creditors or otherwise, or any of these parties acting in combination may formulate and present a workout plan, with or without liquidation. The Article will provide that such a plan should be approved by the debtor, the court in bankruptcy and a two-thirds majority of creditors in each class of creditors and submitted to the syndic or syndics within ninety (90) days of the closure of the classes of creditors under Article 10. Each creditor will have a number of votes according to the proportion between that creditor's claim and the total amount of allowed claims outstanding for that class of accredited creditors, as of the date of closing of the class under

Article 10. In the event of a failure to reach accord on the terms of a plan within this ninety (90) day period the syndic or syndics will have a period of an additional sixty (60) days to formulate a workout plan, during which 60 day period each syndic will represent that syndic's class of creditors in developing a mutually acceptable plan. This Article will obligate the syndics to file an accepted plan immediately with the greffe and obligate the greffe to immediately file same. The Article will conclude in stating that in the event that a plan is not formulated within this time, the syndic or syndics and the bankruptcy court will cooperate to achieve an orderly and prompt liquidation of such debtor assets as are necessary:

- to satisfy creditor priorities set forth in Article 22;
- to achieve at least partial discharge of the debtor thereby; and
- and to the extent possible, to effect the continuation of debtor's enterprise

Article 20 This Article will add that notwithstanding the terms of Article 19, neither the bankruptcy court nor the debtor need approve the workout plan, provided:

1. same was prepared under the auspices of the office of the syndic or syndics, either as representatives of a creditor or a group of creditors formulating a plan or directly under Article 19
2. the plan secures the (i) three-quarters approval within each class of creditors and (ii) three-quarters of the class of secured creditors, as to those aspects of the plan that: (a) place the unsecured creditors in a better position relative to the secured creditors than they would have been absent the plan; and (b) require the liquidation of property in which the secured creditors have their security interest
3. nothing on the face of the workout plan is in violation of Malagasy law
4. there is no direct and compelling evidence of improper collusion or fraud in preparation of the workout plan such that same, if effected, would do discernable and permanent harm to the debtor

This Article will provide that within five (5) days of adoption by the creditors, the syndic or syndics will file same with the bankruptcy court. This Article will continue by providing that, only the bankruptcy court and the debtor will have standing to contest the plan and only on the grounds of either illegality under subarticle 3 or collusion or fraud having the effect set forth in subarticle 4 *supra*.

Article 21 This Article will provide how the bankruptcy court or the debtor may contest a workout plan under Article 20. Both the debtor and the bankruptcy court will be required to contest the plan through means of a filing in the tribunal de commerce within ten (10) days of filing of the plan with the bankruptcy court. The Article will continue by providing that the written statement stipulate the facts or laws giving grounds for the tribunal to invalidate the workout plan. The Article will obligate the tribunal de commerce to reach a determination within sixty (60) days of the filing and will expressly provide that if the tribunal de commerce makes no finding within such period, the workout plan is valid. In the event the tribunal of

commerce invalidates the plan, the bankruptcy court and the creditors are obligated to achieve an orderly and prompt liquidation pursuant to Article 19 *supra*.

Article 22 This Article will discuss creditor priorities in liquidation, whether pursuant to a workout plan or as a result of a failure to reach agreement on a workout plan. (This Article might compactly state the rough listing of priorities as are given in Articles 166 and 167 of the January 10 draft. The Article should, however, give serious consideration to explicit recognition of claims not subject to discharge as set forth in Article 4).

Article 23 This Article will set forth precisely when the debtor is discharged in bankruptcy as a result of the workout plan, with or without liquidation. This Article will provide that the bankruptcy court will enter a final and binding order of discharge upon acceptance of the plan as provided in Article 19 or, in the event of failure to secure approval on a plan, upon final liquidation and payment to creditors as provided in Articles 19 and 21. This Article will provide that final payment to creditors will be deemed to occur upon the transfer of proceeds, from liquidation or otherwise: (i) to that party designated by plan; or (ii) in the absence of a plan, to that party having bankruptcy court authorization, to receive same in order to pay creditors. The tribunal de commerce will develop a uniform statement for filing in the bankruptcy court entitled “Discharge in Bankruptcy” which the greffe is obligated to file immediately upon final payment.

Rationale for Title IV: The overall goal of the Title is to provide for maximum flexibility by both creditors and debtors in the event of that the debtor’s financial circumstances have a direct and concrete adverse effect on creditors.

Title IV, in sum, like Article 52 of January 10 draft, provides that an agreement or a solution without agreement but with liquidation are the two alternatives. Consistent with maximum voluntary accord among the parties, suggested Article 17 expressly provides for the possibility that a voluntary agreement may also provide for liquidation. Articles 52 and 119-30 of the January 10 draft suggest, but do not directly state, that the debtor has the choice between bankruptcy with liquidation and the workout of the debtor’s obligations through a plan that may or may not include liquidation. While the policy direction of the January 10 draft is far preferable to the BL in this regard, clarification is needed. Suggested Article 17 provides it. There is another important point. One important difference between suggested Article 17 and both the BL and the January 10 draft lies in the events giving rise to these possibilities. The BL and the January 10 draft place great emphasis on the debtor’s cessation of payments as the event giving rise to the need for a plan featuring liquidation. Suggested Article 17 adheres to a slightly different philosophy. Rather than focus on the failure of payment, suggested Article 17 lets either the debtor or the creditors decide which way to proceed – either a workout plan with total liquidation or a workout plan with partial liquidation no liquidation that permits the debtor to proceed in business. This makes most economic sense. Article 25 of the January 10 draft sets forth what appears as an accounting standard alerting a debtor when to file in bankruptcy as a matter of legal obligation. In this sense, the January 10 draft offers some improvement over Article 437 of BL, which focuses simply on the fact of non-payment and does not distinguish between inability and unwillingness to pay. However, the standard for failure to pay in draft Article 25 of the January 10 draft is questionable from a policy and practical perspective, as:

- in many inventory and cash sensitive businesses, the ability to reference current debt against ready cash can be difficult
- even were such a calculation possible, measures of “cash flow” tell only part of the liquidity story of a business
- the focus is on short-term trade related debt, but Madagascar in the near future is hoping to supplement this with accelerated long term lending and thus provide a different debt profile for many businesses (World Bank Country Study: Madagascar, International Bank for Reconstruction and Development, 1993, p.p. 152, 154-55)

To illustrate, two concrete examples suffice:

- ***Hypothetical #1*** - a debtor is a successful retailer in a highly seasonal business, the cycle of which is one very profitable quarter of the business year with the other three cycles devoted to the accumulation of both inventory and the debt to finance it
- ***Hypothetical # 2*** - a debtor manages accounts on an accrual rather than a cash basis, manages to obtain credit from banks offering accounts receivable as security and has an excellent credit history based on the debtor’s ability to match loan payments to the payment of long outstanding accounts receivable

These two ***Hypotheticals*** illustrate cases of successful businesses that arguably must nonetheless file for bankruptcy. This is because, at any single moment, they may be found wanting in liquid cash to pay debt on their books. By comparison, suggested Article 17 lets the free market determine when the “redressement” with the workout plan is appropriate by relying on the judgement of the particular parties.

In short, under Article 25 of the January 10 draft, a debtor unable to pay may have a perfectly viable business, even in the eyes of creditors. The debtor may be largely profitable, but partially unprofitable. In this case the remedy may be neither entire liquidation nor a simple remedial plan. Partial liquidation and discharge may be the solution. Suggested Article 17, unlike the January 10 draft, provides this flexibility. Conversely, a debtor in a favorable cash flow position may not be in good long-term financial circumstances. Thus, the accounting standard of draft Article 25 in the January 10 draft is not a good benchmark.

Rather than fix a standard focused on the absence of payment, suggested Article 17 leaves it to the free market to decide the issue by relying on creditors to protect themselves. They may file under suggested Article 6 and then decide whether a remedial plan or a workout plan with whole, partial or no liquidation is in order. The important thing to realize is that the parties decide on the basis of the economics of the debtor firm, not on the basis of an isolated series of events represented by non-payment. To this extent, suggested Article 17 extends a trend manifest in Article 28 of the January 10 draft. That draft Article permits proceedings to open at the initiative of the creditors, an advance over the BL. What suggested Article 17 adds is that the event

triggering the initiation of proceedings should be based on the economics of the debtor firm, as determined by either debtor or creditor, not the narrow issue of non-payment.

Suggested Article 18 is a succinct compression of the most important substantive aspects of Articles 119-93 of the January 10 draft, much of which deal with procedural considerations of execution of a workout plan, as related in Part III *infra*. In the interests of simplicity of the bankruptcy process and efficiency in administration, suggested Article 18 leaves administration of liquidations and transfers in the workout plan with the syndic, thus doing away with the requirement of an “administrateur” (administrator) as provided in Articles 137.4 and 137.5 of the January 10 draft. As noted in the discussion of suggested Article 12 *supra*, the syndic is subject to the standards of droit commun and is thus accountable on questions of execution of the particulars of a workout plan. Similarly, modern commercial reality supports the conclusion that controlling persons as defined in suggested Article 3 should not be deprived of an opportunity to secure assets of the debtor. This is in response to Article 137.1 of the January 10 draft. Such persons, be they controlling persons of the debtor, creditor or syndic, are often those with the most intimate knowledge of debtor’s affairs and thus the best equipped to use debtor’s resources efficiently. Suggested Article 18 rather imposes a standard on the bankruptcy court in reviewing workout plans with these features.

Suggested Article 19 borrows on Articles 119-37 of the January 10 draft, particularly the concern of Articles 122 and 131 for deadlines, to fix one simple date for the accomplishment of an event: the development of a workout plan. The argument for the imposition of one simple deadline is clear, to keep all parties focused on the prompt and decisive reallocation of debtor assets in the name of commercial efficiency. Again, suggested Article 19 carries the reform spirit of the January 10 draft one step further. Articles 556-69 of the BL provides for creditor involvement in the formation of a workout plan (“concordat”). But flexibility and the demands of modern commercial society suggest that no one plan is likely to remain intact and acceptable to large groups of creditors. It is therefore necessary to: (1) place some time limit on the development of a plan; and (2) take full advantage of the representative capacity of the syndic to broker an acceptable plan at the expiration of the ninety (90) day period, giving the syndic or syndics an extra sixty (60) days to effect an agreement. In the event that a plan cannot be produced, suggested Article 19 permits the court to resort to liquidation in cooperation with the syndics, and thus assumes some of the character of Article 127.3 of the January 10 draft. However, the court is not given complete freedom of action. Suggested Article 19 provides some statutorily defined limits, expressing the implicit preference for minimal and efficient liquidation to secure discharge, yet permit the debtor to survive with some semblance of a business intact. The two-thirds voting requirement follows the general standard of BL 557.

Suggested Article 20 adopts the general position that the syndic and the creditors may direct the formulation of a workout plan and unilaterally act to secure its operation, subject to conformity to four stipulated legal criteria. The super-majority voting requirement of three-quarters provides some protection that the views of the court and the debtor will not easily be overturned by creditors. The super-majority voting requirement for secured creditors, in the case of disagreement with the debtor and the court over a workout plan, is in line with the general concern for the special status of secured creditors expressed in such Articles as 121 and 125 of the January 10 draft. But there is a problem with reflecting the interest of the secured creditor as

these Articles do. In renunciation or non-renunciation of the security interest, the secured creditor is presented with a stark choice – to continue the interest or not. Modern commercial reality allows for the possibility that only a partial liquidation of a firm’s assets may be required and thus that a secured creditor may survive as such even following some liquidation. Further, such renunciation as exists would only have utility at plan level were it unanimous and Articles 121 and 125 of the January 10 draft are ambiguous here. Suggested Article 19 poses the more practical solution of super-majority vote for secured creditors on the particulars of a workout plan, which may or may not incorporate liquidation, in case of disagreement with the debtor or the court. It is thus more flexible than the BL or the January 10 draft.

Suggested Articles 20 and 21 do not accord the bankruptcy court or the debtor a final say in the composition of the plan. This is not uncommon in Western financial circles, in which the law defers to creditor interests and expectations through allowing for a “cram down” plan that the debtor must accept. Article 127 of the January 10 draft does not really represent much of an advance over Article 566 of the BL. Neither accommodates the commercial reality that while bankruptcy is a public matter, it essentially advances the public interest through recognition of the self-interest of private parties. That is to say, it recognizes that the creditor self-interest is for the rapid and efficient resolution of the debtor’s indebtedness via a plan. Suggested Articles 20 and 21 recognize the creditor interest but strike a balance by limiting the consideration of the plan under “public interest” criteria to violations of law and cases of fraud or collusion.

Suggested Article 22 has no intention of disturbing the fundamental allocation of priorities set forth in Articles 166 and 167 of the January 10 draft. However, there is a difference between setting forth a theoretical right to be paid and providing for the realistic possibility of payment. Suggested Article 4 provides that certain types of claims are not subject to discharge. But this high legal status does not ensure that such preferred parties will ever be paid from the assets of the debtor’s business. Suggested Article 22, handling as it does concrete priorities at a definite time, does this. Thus, thought should be given to where in the order of priority the creditor interests in suggested Article 4 belong in suggested Article 22. This incorporation has the additional advantage of a transparent treatment of claims for tax and social welfare payments, also treated in Article 4 (at least in certain contexts). Article 81 of the January 10 draft seems to set forth a general principle of the priority of such payments and then resumes with this idea in Articles 149-50. Suggested Article 22 has the aim of magnifying the importance of such public policy statements, making them obvious to the business person by putting them in one place. This had the additional advantage of avoiding ambiguities in interpretation.

Suggested Article 23 is consistent with draft Articles 178 and 204 of the January 10 draft. Collectively, those Articles tie discharge to either liquidation or acceptance of the plan. Article 178 provides that discharge will occur with the deposit of sums in account as a result of liquidation. Article 204 expressly provides that discharge will be the consequence, but does not indicate a concrete event giving rise to discharge. Suggested Article 23 so provides, tying the event to entry in bankruptcy court records rather than to less public bank records.

Citations to Title IV: Most of these have been covered in the *Rationale for Title IV supra*. A summary is that the following suggested Articles simplify, clarify or obviate the need for the following provisions in the January 10 draft:

Suggested Article 17 - draft Article 52
Suggested Article 18 - draft Articles 119-93
Suggested Article 19 - draft Articles 126-127.3, 134-36
Suggested Article 20 - same as for suggested Article 19 *supra*
Suggested Article 21 - draft Articles 216-25
Suggested Article 22 - draft Articles 166-67
Suggested Article 23 - draft Articles 178, 204

TITLE V. REMEDIAL PLAN FOR BUSINESS CONTINUATION WITHOUT LIQUIDATION

Article 24 This Article will provide that the debtor may secure partial discharge of obligations through the creation of a remedial plan for business continuation (hereafter merely referred to as “remedial plan”) in cases including but not limited to instances of financial complications with the debtor, even if the debtor has satisfied obligations to creditors. This Article will further provide that such a remedial plan may or may not include partial liquidation, that partial liquidation may be immediate or postponed for a later date and that partial discharge may be secured without any liquidation. This Article will further provide that such remedial plan may be developed:

- by the filing of debtor, a creditor or a group of creditors expressly indicating a desire to proceed with the development of a remedial plan
- by petition to the bankruptcy court by the debtor, creditor or group of creditors for the transformation from a process for a workout plan with or without liquidation under Title IV into a process for a remedial plan

Article 25 This Article will provide that the procedures and parties necessary to formulate the remedial plan are the same for the workout plan under Title IV. This Article will provide that once the parties are assembled for the development of the remedial plan, the remedial plan can have the content agreed by the parties, subject to the same provisions for approval and contest as apply to the formulation and contest of the workout plan in Title IV.

Article 26 This Article will provide that the debtor, a creditor, any groups or classes of creditors and a syndic or syndics may, in any combination, work simultaneously on the terms of a workout plan under Title IV and a remedial plan under this Title V. This Article will provide that any of such parties may file with the bankruptcy court for this dual purpose. However, this Article will add that only one final plan, either a single workout plan or a single remedial plan, may filed with the bankruptcy court in compliance with Article 19.

Article 27 This Article will provide that the bankruptcy court will enter a final and binding order of discharge upon acceptance of the remedial plan in the manner provided in Article 23.

Rationale for Title V: To accommodate the realities of modern commerce, suggested Title V is a blend of the most progressive features the ‘règlement préventif’ and ‘cas de réhabilitation,’ reflected in Articles 5-9 and 204-07, respectively, of the January 10 draft. The former establishes the ability of debtor and creditor to act in a prophylactic fashion to develop a plan to restructure debtor’s obligations, if the debtor is in financial difficulty, before debtor fails to make payments to creditors. The nature of the agreement with the creditors is open-ended and negotiable. The latter Articles, on rehabilitation, grant the debtor a discharge if creditors have been paid at least in part. The accomplishment of suggested Article 24 is the grant of discharge not only when debtors have paid the creditor but simply when an agreement for repayment or restructured payments is reached. Discharge need not be tied to payment and liquidation but can be secured through agreement of the parties. Among the practical cases accommodated by this solution (and not covered by the January 10 draft) are as follows:

- ***Hypothetical #1*** - a debtor has taken on new obligations that the debtor may not be able to satisfy and at the same time is operating with obsolete equipment that the debtor would like to liquidate when the market for the equipment rises – the solution is a remedial plan with a discharge feature supported by a promise for future partial liquidation
- ***Hypothetical #2*** - a debtor enters into a promising business that nonetheless requires new technology and secures much financing to secure same but becomes overextended in debt obligations – the solution is a remedial plan with a partial discharge feature in return for which the financiers will not receive proceeds from a partial liquidation but rather an equity participation in the new business

In neither ***Hypothetical*** is discharge conditioned on immediate liquidation – or any liquidation at all. The January 10 draft does not speak to such possibilities. Present contract law in Madagascar may already provide for them, in theory. But the existence of the remedial plan option in a reform bankruptcy law will, in practice, give the creditors the encouragement to resolve the situation publicly and *en masse* so that the debtor can proceed with an integrated business strategy that gains the public confidence of the financial community.

Some textual support for suggested Article 24 is found in draft Article 204 of the January 10 draft, which provides that an agreement may be involved in the discharge process (when a third party pays for the debtor) as well as Article 6 of same which suggests that the workout plan (redressement) and the remedial plan are interchangeable, with the latter leading to the former. Yet, the reverse can occur. Commencing work on the workout plan can lead to the conclusion that a remedial plan may be preferable. This would happen in the case of partial liquidation, as illustrated by ***Hypothetical #1***. This example reflects the terms of a workout plan but at the same time leads to the continuation of the debtor business in some modified form pursuant to a forward-looking plan to keep the financially fragile surviving business intact. Suggested Article 24 permits flexibility. It accommodates forward-looking feature of “règlement préventif” with the partial discharge accompanying partial liquidation.

Suggested Article 24 also adds that creditors may file for the remedial plan. This extends the reform direction of the draft of January 10, which introduces the ‘règlement préventif’, a procedure which does not exist in the BL. The ability of creditors to initiate this proceeding

makes ‘règlement préventif’ and the whole idea of a remedial plan an even more viable possibility in advancing the overall policy of creditor rights.

Suggested Article 25 follows the logic that the remedial plan borrows the best of the ‘règlement préventif’ and the ‘cas de réhabilitation’ of the January 10 draft. Because it combines the discharge of rehabilitation with an accord without liquidation as in the ‘règlement préventif’, suggested Article 25 imposes the same standards for creditor approval as are imposed in Title IV.

Suggested Article 26 is in accord with the reform direction of the January 10 draft. The January 10 draft improves upon the BL by adding ‘règlement préventif’ and ‘cas de réhabilitation’. Suggested Article 26 simply adds that decision on which route is best may only be possible after all parties have assembled in the formal bankruptcy process and begun trying to negotiate one solution or the other. It thus enhances the two new reform alternatives of the January 10 draft.

Suggested Article 27 resembles Article 23. Both have the purpose of providing the business person with a reference to a concrete physical event that signifies discharge. Both seek to make this public and transparent through use of the court process.

Citations to Title V: Since this Title is a mixture of the contributions of ‘règlement préventif’ and ‘cas de réhabilitation’, it is entitled as a synthesis of the best economic policy aspects of Articles 5-9 and 216-25 of the January 10 draft. Similarly, Title V is designed to supplant Articles 607-614.3 of the BL.

TITLE VI APPLICATION OF THE LAW AND MISCELLANEOUS PROVISIONS

Article 28 This Article will provide that, subject to Article 29, nothing under this Law on Bankruptcy should be construed to limit the initiation or continuation of criminal proceedings against the debtor or any party for events connected to debtor’s indebtedness, the disposition of the debtor’s estate or the claims of various parties against the debtor.

Article 29 This Article will provide that parties filing in bankruptcy or listed in classes of creditors under Article 10 will enjoy immunity from criminal prosecution in connection with any matter concerning the debtor’s indebtedness, a creditor’s claim or the disposition of any portion of debtor’s estate, provided:

- such parties have entered the bankruptcy process through formal filing or otherwise in good faith
- such parties negotiate their rights while in bankruptcy through the syndic or syndics and otherwise in good faith

This Article will provide also that, notwithstanding the good faith of such party, nothing in this Article will prevent criminal prosecution of any controlling person of such party if grounds for criminal prosecution exist. This Article will provide that such immunity as the Article extends exists only for the duration of formal bankruptcy proceedings.

Article 30 This Article will provide that neither filing with the bankruptcy court, nor the formulation of a workout plan under Title IV, nor the formulation of a remedial plan under Article V, nor any other act taken in good faith by a participant in the bankruptcy process under this Law in Bankruptcy will be construed outside the bankruptcy process as an admission against the interests of the debtor, the creditor, the syndic or any other party participating in the bankruptcy proceedings under this law.

Article 31 This Article will provide that unless otherwise provided, appeal from the determination of a court in bankruptcy is treated as an appeal from any determination of the tribunal de commerce.

Article 32 This Article will provide that this Law on Bankruptcy will be supplemented by a Law on Bankruptcy Procedure. This Article will further provide that in the event of a conflict between the terms of this Law on Bankruptcy and the Law on Bankruptcy Procedure, the terms of this law will prevail.

Rationale for Title VI: These suggested Articles are designed to show how the reform Law on Bankruptcy integrates into related areas of the Malagasy legal framework and also to encourage, to the extent a law can, the desirability of using the court system to resolve disputes between debtor and creditor.

Suggested Articles 28 and 29 go together. They are designed to defer to law enforcement authorities in connection with those aspects of debtor conduct which have the gravest normative or public policy consequences. In this sense, suggested Articles 28 and 29 leave to the law enforcement officials many of the punitive aspects of dealing with the debtor, as set forth in such Articles as 194-96, 203, 203.1, 226, 226.1, 228, 231, 233-34, 237 and 242 of the January 10 draft. At the same time, the suggested Articles are designed to encourage participation in the bankruptcy process by a grant of temporary immunity from criminal prosecution so that the bankruptcy court can evaluate all economic claims. Precisely because the new reform Law on Bankruptcy is not punitive in nature, bankruptcy proceedings could thus be an ally to law enforcement officials by assisting them in “getting to the facts” regarding the debtor’s business dealings and transfers made in connection with them.

Suggested Article 30 extends the reasoning of suggested Article 8 and of Articles 75.1 and 75.2 of the January 10 draft. The general concept of a suspension of proceedings is to permit bankruptcy proceedings to be the central, if not exclusive, forum for the working out of complicated indebtedness problems. Suggested Article 30 further promotes openness and rank exchange by protecting the disclosures of participating parties so that an accord can be reached.

Suggested Article 31 is a point of clarification. The January 10 draft speaks at length in Articles 216-225 of appeal as do such provisions as draft Article 129. But appeal to whom? Suggested Article 31 clarifies Article 4 of the January 10 draft which fixes bankruptcy within the tribunal de commerce.

Suggested Article 32 but confirms the preference that substantive rights under bankruptcy law not be qualified by procedures. The Law on Bankruptcy Procedure will be discussed briefly in Part III *supra*.

Citations to Title VI: As noted, this Title is designed to supplant the many penal and punitive provisions in the January 10 draft and the current law. Among the provisions that should be deleted from any reform bankruptcy law are:

January 10 draft – in great measure Title V of the January 10 draft, particularly Articles 228, 231, 233-34, 237 and 242. Articles 194-96, 203, and 203.1 should also be deleted as unduly punitive.

BL – the entirety of Title III of the current law. Also, the tenor of all provisions suggesting an obligation to file bankruptcy, starting with Article 437 of the current law, needs to be re examined. The key is to provide incentive to file, not condemnation and punishment.

Otherwise, the only connection between Title VII of the January 10 draft, which similarly addresses miscellaneous provisions, and suggested Title VI is in the area of discussion of criminal law. Article 249 of the January 10 draft does a cross-reference to the Penal Code without elaboration. By contrast, suggested Articles 28 and 29 are intended to provide real guidance to the business person as to the connection between penal and bankruptcy law, with the view to encouraging participation in the bankruptcy process.

III. LAWS RELATED TO A LAW ON BANKRUPTCY

A. Law on Bankruptcy Procedure

Stephen Hawking, the holder of the Sir Isaac Newton Chair in Physics at Cambridge University and best selling author, was once asked how it was that a physicist could write a best selling book. The answer is simple, he responded: the number of book sales is inversely proportionate to the number of mathematical formulae employed in the book. Minimize the number of formulae and you popularize the book.

So it is with the use of provisions on court procedure in commercial laws. The extent to which a law is known and used by the public of businessmen and financiers is inversely proportionate to the amount of court procedure discussed in the law. The accessible commercial law enables the end user, the business, not the lawyer or the judge, to know its rights quickly and easily.

This is true of all commercial laws, whose end users are results-oriented businesses. This is especially true in the case of bankruptcy. This is because in the bankruptcy context, it is not only that businesses do not want to plow through highly technical and often arcane court procedures. It is that businesses cannot. The debtor, often in desperate financial straits, cannot afford a lawyer to explain such things. The debtor thus cannot take the vital first step in bankruptcy, the act of filing, because the debtor cannot sort out the consequences of using the bankruptcy law through the maze of a court procedure that the debtor cannot understand. Nor is the creditor

likely happy with a bankruptcy law heavily oriented to procedure. Even for the creditor with resources and lawyers, excessive court procedure suggests delay. And delay makes creditors impatient. And when creditors become impatient, they avoid use of a law in favor of other means to obtain a settlement by other means, including private, one-on-one dealings with the debtor. The failure to use the bankruptcy law thereby increases public cynicism as to the law's value. The whole dynamic leads to a bankruptcy law that is an eroded "dead letter."

The above description very closely fits the current situation with Madagascar's bankruptcy law. Without even discussing the merits of the substantive aspects of the current Malagasy bankruptcy law, the stranglehold that excessive court procedure exerts on a bankruptcy law could well explain in large degree the failure to use Madagascar's current bankruptcy law. This is not to say that all procedural articles are unimportant. To the contrary, when procedure is discussed, it should be on the most important points to the business and should have great prominence in the legal text. The following points should be observed treating procedure in a new draft of a Law on Bankruptcy for Madagascar:

1. *Focus on the Alpha, the Omega and Minimize the In Between* – Both the debtor and the creditor business want to know two essentials: not only how to begin bankruptcy proceedings but why to begin them. The "how" of the beginning relates to the "why" of the end, the "bottom line" for the business. For the debtor, the emphasis on discharge and how discharge is secured in concrete procedural terms is the end game and the only reason for filing. For the creditor, the emphasis is on recovery and how the creditor stands versus the claims of other creditors. Thus, such procedural articles as deal with the creditor need to focus on classes of creditors and representation through the syndic. Suggested Articles 1 and 10-12 of the proposed Law on Bankruptcy deal with these issues of discharge and creditors' rights, and do so reasonably early in the text to give them prominence. As promotional vehicles to encourage filings in bankruptcy they compare quite favorably with the BL, the first article of which uses procedure as an instrument of compulsion.
2. *Treat Procedure in Concrete, Physical Terms* - Whether creditor or debtor, the business that subjects itself to transparent public scrutiny expects to be able to monitor progress as to those few procedures of crucial importance. This means removing procedure from the realm of legal theory. It means making procedure tangible. Thus, articles in a reform law should tell the business exactly what papers to file and where to file. Yes, what papers to file and the address at which to file them. Procedural articles should be drafted so that bankruptcy filing becomes for the debtor and even the creditors a lawyer free, "do it yourself" exercise. Procedural steps should be characterized by a reference to the paper in question to be filed and who is responsible for the filing. Suggested Articles 5-6 of the proposed Law on Bankruptcy do this in the context of filing. Suggested Articles 23 and 27 do so in the context of discharge. This is in stark contrast to such provisions as Articles 72, 75, 77, 127, 129, 132 and 134-36 of the January 10 draft which confine treatment of such apparently important procedural concepts as "la decision d' ouverture" (on commencement of proceedings) and "homologation" (on confirmation of court) to the realm of legal theory. The debtor and the creditor have little evidence of when such steps begin and hence little ability to appreciate their importance.

3. *Eliminate Indirect Procedures from the Substantive Law* – The proposed Law on Bankruptcy avoids detailed reference to court procedures between court administrators and judges as well as intermediate procedural steps in the context of judicial sales, the verification of creditors and the like. This is not to say that the public should be unaware of the existence of such procedures; in fact a provision such as suggested Article 32 that cross-references to a separate Law on Bankruptcy Procedure suffices. This is in the interest of transparency, not in derogation of it. Detailed descriptions of intermediate procedural steps and those only indirectly impacting the debtor and creditor merely distract from the important procedural aspects of bankruptcy as outlined in Point # 1 above.

Accordingly, most procedural articles, be they in the BL or the January 10 draft, belong as part of a Law on Bankruptcy Procedure (be it an addendum to the Code of Civil Procedure, rules of court or a separate law). The addition of procedural articles to the text of the reform Law on Bankruptcy above should be made with the greatest care, taking into account the paramount consideration of the usefulness of the law to businesses. Accordingly, only those procedures should be added that are especially tied in the most direct manner to the substantive rights of the debtor and creditor. To illustrate, the current draft of January 10 presents the following rough breakdown of substantive as opposed to procedural provisions:

Substantive articles 1, 2 bis, 3-4, 5-7, 9, 25-28, 67-71, 72-77, 91-118, 194-99, 203-07, 226-51

Procedural articles – 2, 8, 29-38, 39-51, 200-02, 208-14

Intermediate articles – 52-66 bis, 78-90, 97 bis, 119-93, 215-25

For the most part, serious consideration should be given to the incorporation of the central ideas in the latter two categories into a Law on Bankruptcy Procedure.

In limited doses, the introduction of the most essential procedural provisions can help enhance the utility of a Law on Bankruptcy to the business community. But an excessive procedural emphasis threatens to overwhelm the positive substantive economic message that such a reform law can convey. Hence, serious consideration should be given to a separate Law on Bankruptcy Procedure – both in the interest of bankruptcy and in the interest of proper procedure.

B. Law on Fraudulent Conveyances

Focusing as it does on the complex financial dealings of an entire firm interacting with many parties, the bankruptcy process cannot possibly deal with every single debtor-creditor dispute. This is especially the case as to those disputes that allege lack of good faith or other misbehavior by the debtor. Such normative concerns are really outside the central purview of bankruptcy, which should be focused on economic efficiency.

This is all the more the case in view of the salutary reforms introduced by the January 10 draft. Compared with the BL, both ‘règlement préventif’ and ‘cas de réhabilitation’ in the January 10 draft accommodate new economic realities by offering debtors and creditors more choice. But they also impose additional burdens on the court in bankruptcy by requiring the supervision of

ever more detailed workout agreements and offering the potential for complex asset sales in more contexts.

All of this is an argument for relieving a stressed bankruptcy court system. This system needs relief from the burden of acting as a referee in essentially two party squabbles over the misappropriation of property. A Law on Fraudulent Conveyances would do this. Such a law would prevent:

- the questionable sequestration or transfer of debtor assets in general, and especially prior to filing bankruptcy proceedings
- the manipulation of the syndic, the notary (“notaire”), the greffe or any officer of court to further such sequestration or transfer
- collusion between creditors and the debtor with respect to the classification of obligations considered by the court in a bankruptcy case

A separate Law on Fraudulent Conveyances, fixing creditor remedies for improper transfers by debtors, would lie outside the bankruptcy system. Yet, it would strengthen and complement bankruptcy reform of the sort discussed in Part II B *supra*. In addition to relieving the bankruptcy courts of responsibility in cases of improper debtor transfer, it would:

- protect bankruptcy courts against debtor abuse of the bankruptcy process at precisely the time when such courts need to reallocate resources to address sophisticated economic issues
- enhance the transparency of the bankruptcy process in reinforcing the view of classes of creditors having common interests by providing the “safety valve” of individual creditor actions against a debtor for fraudulent transfer outside the bankruptcy process
- add credibility to the economic grounds for workout and remedial plans by transfer of discussion of normative and penal concerns in the civil context to legal actions outside bankruptcy
- bolster public confidence in the greffier and other administrative officials involved in the bankruptcy process by having a separate court treat allegations of official misbehavior and abuse of the bankruptcy process

So linked is a Law on Fraudulent Conveyances to a reform Law on Bankruptcy that there is much merit in considering the two in tandem. Both laws underline the overall message of reform. Instead of viewing a bankruptcy as a “catch all” for every debtor-creditor grievance, Madagascar can transform bankruptcy into its proper, central role in the equitable and transparent resolution of some of Malagasy society’s most protracted economic problems. All corners of an increasingly complex and diverse economy demand - and deserve- no less.